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STIMULATING COMMUNITY ENTERPRISE: A RESPONSE TO FISCAL STRAINS IN THE PUBLIC SECTOR

A STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
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LETTERS OF TRANSMITTAL

December 26, 1984.

To the Members of the Joint Economic Committee:

I am pleased to transmit a study entitled "Stimulating Community Enterprise: A Response to Fiscal Strains in the Public Sector," prepared by a consulting group from the Sabre Foundation for the Joint Economic Committee.

This study was commissioned by the Joint Economic Committee to explore new opportunities for dealing with fiscal strains and resolving shortcomings in public service delivery. The focus of the study is on strengthening neighborhood self-sufficiency as a means of reducing dependency upon governmental services. Accordingly, the report emphasizes two areas: First, removing obstacles now facing self-help associations at the community level, and second, estimating the fiscal impacts of transferring public services responsibilities to such associations.

The views expressed herein are those of the consulting group and not necessarily those of the Joint Economic Committee or its members.

Sincerely,

Roger W. Jepsen,
Chairman, Joint Economic Committee.

December 21, 1984.

Hon. Roger W. Jepsen,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, DC.

Dear Mr. Chairman: State and local governments are facing serious fiscal problems. On the one hand, the quantity and quality of the goods and services that they supply are declining. While on the other hand, the demand for these so-called public goods and services is increasing. Traditionally, any such gap between demand and supply was filled by a heavier reliance on the following sources of public finance: state and local taxes, bonds, or federal grants.

But, the never-ending stream of public funds to finance increased supplies of so-called public goods and services has come to an end. The threat of tax revolts has made tax increases politically unpopular. Voters have turned out in record numbers to reject bond referenda. In many cases, jurisdictions are facing constitutional debt limitations. And the prospect of increased federal grants is indeed remote. It is clear that, unless new private methods of financing and supplying so-called public goods and services are found and promoted, State and local governments will continue to face growing fiscal crises.

A discussion of such private, innovative solutions for financing so-called public goods and services is found in "Stimulating Community Enterprise: A Response to Fiscal Strains in the Public Sector," a report prepared by a consulting group from the Sabre Foundation for the Joint Economic Committee.

Sincerely,

STEVEN D. SYMMS, *Chairman,*
Subcommittee on Monetary and Fiscal Policy.

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STIMULATING COMMUNITY ENTERPRISE: A RESPONSE TO FISCAL STRAINS IN THE PUBLIC SECTOR*

EXECUTIVE SUMMARY

Much as domestic policy in the early 1980's concentrated on incentives for business expansion, public policy in the balance of the decade can foster increased community self-sufficiency. This report sets forth a means by which voluntary organizations can help relieve fiscal strains at all levels of government.

The most basic obstacle facing voluntary organizations seeking to provide public services is the problem of the "free rider." For many types of public goods, it is difficult to withhold the benefits of a service from those who refuse to share in its costs. Private groups typically have had to rely on the goodwill of donors and volunteers to sustain civic improvement efforts.

With surprising speed over the past two decades, however, private sector organizations have been adopting a fundamentally different method of financing and providing public services. The new method—based upon private self-assessments—is most clearly embodied in homeowners' associations. All propertyowners in such associations regularly share, under a binding deedbased agreement, the costs of facilities and services that benefit all. From fewer than 600 associations in 1964, self-assessing homeowners' organizations have increased to more than 25,000 at present.

Homeowners associations today finance and provide streets, water and sewer systems, emergency services, daycare, and recreational services. In contrast to public sector bodies, the associations have strong internal incentives to meet service needs of residents, while avoiding featherbedding and other excessive costs in arranging for basic service delivery.

Associations have also proven highly effective in reducing crime, as a result of creating a social fabric strong enough to support block watches and other passive crime prevention measures. The deed agreements, moreover, usually require propertyowners to maintain their homes in good repair, thereby making neighborhoods resistant to physical decline.

Beyond relieving governments of service responsibilities, homeowners' associations have strengthened property values and improved property tax bases. Surveys undertaken for the Urban Land

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*Acknowledgments: R.B. Bowring, project manager; Mark Frazier, principal investigator and author; Peter J. Ferrara, Dick Cowden, and Alex Russin, coauthors; Prof. Steve Hanke, adviser.

Research and writing for this project were conducted under the aegis of the Sabre Foundation, a nonprofit Washington-based research group specializing in methods of strengthening the voluntary sector, and by Free Zone Authority, Ltd., a nonprofit organization specializing in tax incentives for economic and community development.

Institute, the Department of Housing and Urban Development, and the Institute for Community Design Analysis have found properties in homeowners' associations consistently to have higher values than properties in otherwise comparable neighborhoods elsewhere.

Yet the associations to date have achieved only a fraction of their potential. To strengthen community self-sufficiency, this study suggests that consideration be given to removing or reducing the following constraints:

1. Adverse tax policies.—Federal tax policies discriminate against service delivery by private, self-assessing associations. At present, individuals may deduct tax payments for municipal services when calculating their federal income tax, but may not deduct any fee payments to their associations for identical services. This inequity is compounded at the local level. Members of self-assessing associations find that local governments continue to demand taxes for municipal services, regardless of the extent to which association members have arranged and paid for alternative services. Consequently, homeowners associations have no incentive to assume added public service responsibilities.

2. Problems with "holdouts."—It is often difficult to mobilize homeowners to form a deed-based, automatic-membership association: holdouts know they can benefit from association efforts without paying the self-assessments. Homeowners associations generally achieve universal membership only in new subdivisions and new communities, where private developers from the outset require homebuyers to join associations as a condition of sale.

3. Ineffectiveness in assisting the poor.—Homeowners' associations at present are a limited vehicle for meeting the service needs of tenants in low income areas. The associations seldom if ever devote resources to provision of services for the disadvantaged. Moreover, homeowners' associations can dislodge low-income residents from their neighborhoods. As a result of association-generated improvements in neighborhood living conditions, property values often rise sharply, leading to displacement of those who rent rather than own their homes. Formation of propertyowners' associations in some economically distressed areas has been followed by a 200 to 300 percent appreciation in property values within three years, as neighborhood improvements took hold.

Under present circumstances, homeowners' associations seem to have few prospects of relieving the public sector of service responsibilities on a large scale. New policy initiatives, however, may infuse powerful energies into community enterprise.

RECOMMENDED ACTIONS

Steps can be taken in the near term to resolve each of the fundamental problems cited previously, and to generate fiscal dividends for governments at all levels. These actions include:

1. Changing tax policy.—Congress should extend deductibility to the portions of association fees that fund government-like services, to correct the systemic bias in favor of public rather than private service provision. Alternatively, Congress could achieve the same result by eliminating altogether the deductibility of local tax payments.

At the local level, cities should offer relief from "double payments" problems. Houston, Texas and Kansas City, Missouri have extended virtual tax rebates to existing propertyowners' associations that opt out of municipal refuse collection services and arrange for private alternatives. This approach has relieved the municipalities of costs for serving approximately 200 associations.

Such reforms can be readily implemented on a fiscally-sound basis. Governments can set the amount of tax deductions or rebates to be somewhat less than the savings that accrue to the public sector from transferring service responsibilities to homeowners' associations, thereby "profiting" whenever a neighborhood becomes more self-sufficient.

2. Inducing holdouts to join self-assessing associations.—In areas where no homeowners' associations now exist, the provision of "challenge grants" can stimulate participation by homeowners who would otherwise stay on the sidelines. Governments can offer tax relief and/or other benefits to association members once a threshold level of participation in a deed agreement (perhaps 50 percent of the homeowners on a block) is achieved. The size of "challenge grant" benefits to each member should increase to the degree that participation approaches 100 percent.

Opportunities also exist for insurance and realty firms to provide challenge grants for neighborhoods. Insurance companies are beginning to offer low-cost group policies to entire homeowners' associations, as a way of expanding their client base. Some insurance brokers appear agreeable to offering challenge grants for homeowners to form new associations capable of buying group policies. Under this approach, individuals could lower their homeowner insurance rates by up to 30 percent annually simply by joining the association. Similar deals might be struck with real estate brokers—realtors contacted by project researchers expressed a willingness to offer start-up challenge grants and to lower commission rates, provided that association members reciprocated with exclusive listing arrangements when they sold their properties.

3. Safeguarding the interests of the poor.—Two basic approaches can be applied to ensure that homeowners' associations directly benefit the disadvantaged. First, governments can make their incentives to landlords within impoverished areas subject to approval by tenants. Such a policy would induce associations of propertyowners to share with tenants part of the benefits from appreciated property values, perhaps in return for cooperation by tenants in cleanup/fixup, crime prevention, or other initiatives to make the neighborhood more attractive. Deed covenants of propertyowners' associations thereby would become instruments of inclusion rather than exclusion.

Second, governments can assist the disadvantaged by transferring idle public property to Neighborhood Development Organizations (NDOs), and then encouraging nearby landlords and homeowners to form associations that reduce problems of crime and blight. NDOs today are delivering a range of community services of direct benefit to the poor, including low-income housing, job training, nutrition, health care, and social services. For revenue, many NDOs recently have begun undertaking inner city property development projects to support these services. Homeowners' associations can increase the financial return of NDO-sponsored property development projects by helping reduce crime and physical blight that greatly depress inner city property values. As homeowners' associations improve these conditions, NDOs can capture the benefit of windfall increases in land values.

FISCAL IMPACTS

The fiscal health of the country could be measurably improved through adoption of these new incentive policies. Empirical studies indicate that some public service delivery costs can be cut by 30 to 60 percent, as a result of the ability of homeowners' associations to "shop around" among contractual service providers rather than remain dependent on often less-efficient governmental bodies. As of FY 1985, federal programs such as revenue sharing, social services block grants, training and employment services, subsidized housing and AFDC consumed more than $26.7 billion in public resources; local police, sanitation, parks and recreation, housing, and transit services consumed an additional $45.7 billion. Assuming that between 1 and 10 percent of these service responsibilities can be transferred to strong neighborhood organizations, annual savings in service delivery costs—ranging from $724 million to $7.24 billion—can accrue to the public sector.

In addition to conserving public resources, effective neighborhood self-help organizations have a potential to generate new revenues for federal, state and local governments. They can achieve this at the federal and state level by reducing deductions that will otherwise be taken for local tax payments. (As neighborhood self-sufficiency increases, demands for municipal spending—and hence local taxes—stand to diminish proportionally.) By reducing deductions for local taxes, strengthened neighborhood self-help capabilities might generate as much as $264.9 million annually in new revenues at the federal level. At the local level, public finances stand to gain from the significant appreciation in property values that accompanies formation of strong self-assessing associations. Federal incentives to encourage neighborhood associations could generate up to $2.256 billion in property tax revenues for local governments by this means.

The United States is at a crossroads. In response to present fiscal constraints, Americans may opt for increases in taxes and an attendant continued dependency upon their government. The alternative consists of mobilizing the private sector to assume greater responsibility for community well-being, an approach already adopted by more than 25,000 homeowners' associations. With appropriate incentives from the federal government, voluntary community enterprise can take the country further toward the goal of self-sufficiency for all.

I. INTRODUCTION

This study was commissioned by the Joint Economic Committee to explore new opportunities for dealing with fiscal strains and resolving shortcomings in public service delivery. The focus of the study is on strengthening neighborhood self-sufficiency as a means of reducing dependency upon governmental services. Accordingly, the report emphasizes two areas: first, removing obstacles now facing self-help associations at the community level, and second, estimating the fiscal impacts of transferring public services responsibilities to such associations.

Research for the study was conducted over a twelve month period by associates of the Sabre Foundation, a nonprofit research organization based in Washington, DC. The emphasis of the work was on identifying proven, practical techniques for strengthening community self-help. During the course of the project, researchers examined the extensive literature on homeowners' associations and neighborhood development organizations, interviewed realtors and insurance companies specializing in Planned Unit Developments, condominium associations, and inner-city revitalization efforts, and conducted field research into the working of municipal incentive programs in Kansas City, Missouri and Houston, Texas that encourage homeowners' associations to assume responsibility for public services.

The findings presented in this report, while suggesting workable yet innovative alternatives to traditional approaches to urban policy, are viewed by the authors as a starting point for further analysis rather than as a definitive prescription. Resource constraints of the project have rendered the fiscal impact projections, in particular, illustrative rather than exhaustively indicative of potential benefits accruing to levels of government in question.

The authors would like to express their appreciation to a number of individuals who contributed to the research effort, by offering guidance, crucial insights and/or experiences. These include Bruce Bartlett and Dan Roberts of the Joint Economic Committee; Prof. Steve Hanke, The Johns Hopkins University; Douglas Kleine of the Community Associations Institute; Winfield Sealander of Sealander Brokerage; Barbara Wick, of Condominium Insurance Specialists of America; and Jeff Brown of Valley Forge Insurance Management. Responsibilities for any errors or omissions in the report, of course, rest with the authors.

II. FISCAL PROBLEMS AND THE CONVENTIONAL RESPONSES

In recent years, Federal, state and local governments have suffered some of the most serious fiscal strains in history. Government involvement in a spectrum of programs has increased demands for revenue, which policymakers have attempted to meet through taxes, inflation, and public borrowings.

This chapter begins by examining the severity of the fiscal plight of the government at the Federal, state, and local level. It then analyzes a principal cause of the present crisis in public finance: the inefficiency of the public sector relative to the private sector in service provision. Following a review of the adverse effects of these ineffiencies, the chapter concludes with a discussion of traditional remedies proposed for resolving the country's fiscal dilemmas.

A. GOVERNMENTAL FISCAL DIFFICULTIES

1. Federal Fiscal Problems

The Federal government today faces fiscal strains of extraordinary proportions for a time of peace. The recent budget report of the President estimates the Federal deficits to be $184 billion for fiscal year 1984 and $180 billion proposed for 1985. These deficits are down only slightly from the all time high in FY83—$195.4 billion (Annex A, Table 1). These deficits each almost equal the estimated net private savings in their respective years.[1] The FY84 deficit is estimated to be equal to 5.2 percent of the GNP and the proposed FY85 deficit is estimated at 4.6 percent of GNP. The FY83 dificit was a monumental 6.1 percent of GNP. Though continued economic recovery and additional tax and spending adjustments may reduce the deficit in the next few years, it will remain extremely large for the foreseeable future.

A principal cause of the budget strain has been the dramatic growth of social spending programs in the postwar period. The growth in total grant-in-aid programs has been particularly noteworthy since 1940 (Annex A, Table 4). From a low of 0.9 percent of the Federal Budget in 1945, these programs grew to a high of 17.4 percent in 1978. Although they have fallen relative to the budget to 10.8 percent in 1985, reflecting cuts in both the Carter and Reagan administrations, these programs are continuing to grow in absolute outlays. Indeed, overall Federal spending has kept expanding relative to GNP, while taxes in recent years have remained stable (Annex A, Table 5).

EDITOR'S NOTE.—See footnotes at end of study.

Grants to states and local governments amount to 10.5 percent of total Federal spending in the proposed 1985 budget (Annex A, Table 2 and 2a). These funds, $99.2 billion, are distributed through 259 separate programs. Among the major grant programs are Medicaid, AFDC, housing assistance and other income security programs, highway construction grants, mass transit, CDBG and UDAG, and revenue sharing (Annex A, Table 3). About one half of the grants to non-individuals and one fourth of the total grants, are for capital expenditures.[2]

Despite the volume of Federal funds spent to meet social needs, a number of observers have questioned whether the results have been commensurate with expenditures. One of the major problems has been the estrangement of the residents of communities targetted for urban renewal programs from the decision-making process. Washington officials have exercised tight administrative control in an effort to route local economic development in a federally prescribed direction. Angered and displaced from their homes, many low-income citizens have felt like victims rather than beneficiaries of these federally funded urban revitalization projects. In recent years, increased efforts have been made to decentralize urban policy programs, encouraging local direction of local resources. City officials have recognized the need for grass-roots participation and private sector mobilization has been used to achieve social goals. Yet many questionable programs remain—the failures of past expenditures to fundamentally resolve social problems are used as justifications for further government spending.

2. State Fiscal Problems

States have historically maintained significant positive budget balances from year to year (Annex A, Table 6). Those positive balances have decreased in recent years, prompting states to cut expenditures and raise taxes to avoid deficits.[3]

Aggregate state budget balances fell by $4 billion in fiscal 1983, to an insignificant $291 million.[4] Even to maintain this modest balance, 27 states made across the board spending cuts, 37 made selective cuts, 27 adopted permanent tax increases and 24 adopted temporary revenue increase. Collectively, 38 states raised taxes in 1983 by approximately $7.5 billion, and more than half of all states raised their major taxes, the personal income tax or general sales tax.[5] The outlook is for continued difficulty.

Three measures of state spending were at record levels in absolute terms in fiscal 1982: total state government expenditures, direct state expenditures (total expenditures minus grants to local government and payments to the Federal government) and own funds state expenditures (total expenditure minus Federal grants-in-aid and minor payments from local governments) (Annex A, Table 7). Education is the biggest item at 33.2 percent of total spending, and education and welfare, the next biggest items, bring the total to more than half of total spending (Annex A, Table 8). Adding insurance trust expenses and highways yields 70 percent of total spending.

Total state government revenues in fiscal 1982 were $330.9 billion, or 11.1 percent of GNP. Own source state revenues—total state revenues minus Federal grants-in-aid and minor receipts from local governments—equaled $261.8 billion in fiscal 1982, or 8.7 percent of GNP. Both of these measures of state revenues were again at record levels in absolute terms in fiscal 1982 (Annex A, Table 7).

As a percentage of GNP, state revenues under either measure show a very similar pattern to state expenditures. After slow but steady growth in the 1940s, 1950s and early 1960s, state revenue growth relative to GNP accelerated sharply in the late 1960s and early 1970s, stabilizing in 1976, peaking in 1977 and stabilizing thereafter. State revenues were equal to about the same percentage of GNP in 1982 or 1976. However, both measures show renewed growth as a percentage of GNP from 1979 to 1982. In fiscal 1982, intergovernmental revenues, the second largest revenues source (Annex A, Table 9). The largest source was state taxes, almost one fourth of total revenues, and almost one third of state own source revenues.

3. Local Fiscal Conditions

The 1983 annual report on the fiscal conditions of the cities by the Joint Economic Committee (JEC) and the Municipal Finance Officers Association (MFOA) found those conditions also to be among the worst ever, and in many respects still deteriorating.[6] Approximately 43 percent of cities examined had operating deficits in 1982, up from 38 percent in 1981. The amount was projected to increase to 64 percent in 1983 (Annex A, Table 10). However, prior annual surveys have regularly showed that more cities have budgeted for a deficit the following fiscal year than have actually resulted.[7] The report's figures for fiscal 1982 and projection for 1983, moreover, do not reflect the increasingly strong economic recovery beginning in 1983, which may have improved city fiscal conditions more than anticipated.

Nevertheless, the more recent annual report on city fiscal conditions by the National League of Cities found that city expenditures grew more rapidly in fiscal 1983 than city revenues, indicating continued fiscal strains.[8] It also projected expenditures to grow more rapidly than revenues in fiscal year 1984, though not by as great a margin as in 1983 (Annex A, Table 11).[9]

Two measures of local government spending were at record levels in absolute terms in fiscal 1982 (Annex A, Tables 12 and 12a). They are total local government expenditures ($311.4 billion, or 10.4 percent of GNP) and "own funds" local expenditures—total local expenditures minus Federal and state grants-in-aid ($195.4 billion, or 6.5 percent of GNP). This last measure indicates the proportion of total government spending local governments add to the Federal spending (Annex A, Table 7).

An examination of the revenue patterns for local government indicates that Federal and state aid that has fueled local government growth over the past twenty years. Total local government revenues were $313.1 billion in fiscal 1982, or 10.4 percent of GNP. Own source local revenues—total local revenues minus Federal and state aid—were $197.2 billion, or 6.6 percent of GNP. Both measures were again at record levels in absolute terms in that year.

Both measures of local taxes show a renewed trend of growth as a percent of GNP since 1979.

Local government revenues consist first of Federal and state aid at 37 percent, with property taxes second at 25.2 percent (Annex A, Table 13). If user fees are defined to include utility and liquor store income, then this source accounts for 20.3 percent of total revenues, the third most important source. Even without utilities and liquor stores, user fees would still be the third most important local revenues source, accounting for 13 percent of local revenues. These first three revenue sources, including utilities and liquor stores, account for 80 percent of total local revenues.[10]

The 1983 JEC/MFOA and National League of Cities reports noted some trends of change in city revenues.[11] The proportion of intergovernmental revenues was reported to be falling, due primarily to cutbacks in aid by the Federal government. Effective tax rates on property and business activity are also reported falling slightly. Cities have recently sought to offset these declines with increase in income taxes and, to a lesser extent, sales taxes, but few further tax increases are planned. Recent years have also seen substantially increased reliance on user fees, but that is now slowing. Tax reductions and limitations referenda were reported to be a key factor in the reduction of property taxes, increased reliance on user fees, and plans generally to forego further tax increase efforts. Overall, the trends indicate increasing diversity in city revenue sources and increasing reliance on their own sources (Annex A, Tables 13a and 13b).

The available data suggest that city government fiscal problems may be due to the same fundamental imbalance responsible for Federal fiscal problems—tax revenues have stabilized while expenditure growth continues to gallop ahead.[12] Although the recession can be blamed for part of the slowdown in revenues, if expenditure growth does not structurally match slowdown in GNP and revenue growth, a fundamental problem then exists in controlling expenditures. Moreover, the slowdown in revenue growth is at least partly due to taxpayer-voted limitations and reductions in local revenues.

As with other levels of government, efforts by localities to resolve basic problems through spending programs have also fallen short. Municipal police and fire services have benefited greatly from increased budgets during recent decades, but have made little headway in reducing victimization rates. Paramedic and transit systems consistently lose money. In recent years, however, some hopeful signs have appeared. After a long decline in student achievement levels, public schools appear to be more successfully equipping graduates with basic skills. The experience of schools indicates that improved service delivery does not necessarily entail more money.

B. Efficiency of Public Services

The past fifty years have witnessed the increasing displacement of private sector activity by public operations at all levels. This phenomenon gives cause for concern for proponents of efficient public resource allocation.

Unlike the private sector, market forces do not operate effectively within monopolistic government bureaucracies. Few incentives exist for government programs to be administered or executed in a businesslike manner. Lacking internal incentives to economize, public sector programs operate on negative benefit-cost ratios more frequently than their private sector counterparts. The result is to unnecessarily preempt resources for services that generally can be provided more economically by other means.

An analytic and empirical critique of public sector service delivery systems is an essential first step to identifying workable solutions. The following summarizes findings of a growing body of literature on the economics of public services.

1. Background

As a starting point for evaluating the performance of public or private sector institutions, may observers have drawn attention to the critical role of incentive systems that reward or penalize decisionmakers. A private business must maintain a desirable product simply to attract customers, giving it powerful incentives to keep costs low and quality high since its customers may otherwise be lost to competitors who offer a more enticing product package. The benefits and pressures of competition permeate the private sector environment, while government operations function without such competitive input.

A government monopoly is guaranteed customers because taxpayers are bound to pay whether or not they find the product desirable. As long as customers must pay for government services through taxes, the governmental monopoly has no incentive to increase profits or revenues by lowering costs, improving quality or increasing innovation. The dominant incentives in a government bureaucracy discourage efficiency. As a bureaucracy's budget and work force grows, the income and prestige of the bureaucracy's manager increases, as does the job security and opportunities for lower-level employees. Greater efficiency, by contrast, tends to reduce budgets and work forces, while innovative measures are likely to cause controversy without offsetting benefits to the bureaucracy.

There is an additional aspect of private market competition which explains its economic superiority to government monopoly. With the opportunity to provide a service generally open to all companies the possibilities for product improvement are greatly multiplied. In a competitive framework, the shortcomings of one firm may be addressed through the methods of another firm, with each potential supplier testing different strategies. Once a successful new method is discovered, competitive pressure generally lead to its adoption throughout the industry. In those instances where product diversity is desired, firms can tailor their output to satisfy specific market segments. However, there are few incentives for a governmental monopoly to strive to satisfy a variety of consumer tastes.

2. Empirical Evidence

Numerous empirical studies have concluded that public sector bureaucracies tend to provide state and local services at far greater cost than do private sector organizations. In their comprehensive study,[13] Professor E. S. Savas and Barbara J. Stevens examined garbage collection service nationwide. Considering comparable services,[14] they found that in cities over 50,000 in population, the cost of municipal garbage collection bureaucracies was 61 to 71 percent greater than for private firms under contract with city governments.

Another key study focused on fire protection. The city of Scottsdale, Arizona has long contracted with a private firm for the provision of fire protection services to the city's residents. When compared with the costs of a municipal fire department in 44 similar cities, Scottsdale residents are found to be receiving equivalent services for half the cost. Transportation services, moreover, have also been shown to be more economical when provided by private companies.[15] Social services show similar differences: in a study of nursing home services for the Veterans Administration, it was found that the average cost per patient day was 83 percent higher in homes operated by the V.A. than the cost of comparable care provided by private facilities performing the same service.[16]

Privatization comes in many forms, but two fundamental types exist. First is a service delivery system financed with continuing assistance from the public sector, in which private organizations are given responsibilities for service delivery. The second, more thorough-going form of privatization consists of private financing as well as provision of a public good.

I. PRIVATE DELIVERY, PUBLIC FINANCING

Perhaps the most familiar form of privatization is known as "contracting out," whereby state and local governments contract with a private sector organization to provide its service for a set time to eligible residents in return for a contract price paid by the government. The state or city announces that such a contract is available and takes competitive bids from all interested private sector entities. By setting the contract for a limited period, such as one or two years, and accepting competitive bids at renewal time, the contract-winning firm remains subject to market pressures.

Competitive pressure can also be maintained by granting each contract for only part of the city or state and awarding contracts to several different firms. This will maintain a steady supply of active, operating competition ready to bid on each contract at renewal.

An additional alternative is known as "franchising." The state or city grants a "franchise" to a private sector firm to provide a specific service to state or city residents, and the firm receives a monopoly right to directly bill customers. The franchised firm can be chosen competitively, with periodic competition renewals, or several suppliers can be franchised, creating ongoing competition.[17]

II. PRIVATE DELIVERY, PRIVATE FINANCING

One type of full-scale privatization consists of turning over basic service responsibilities to businesses on non-exclusive basis. In Whichita, for example, the municipal government opted for "load shedding" of refuse collection services to the private sector. Virtually any firm is eligible to offer its services, and to charge what the market will bear. The problem with such approaches is their limited applicability to provision of true public goods, where it is difficult or impossible to keep benefits of a service from reaching those who decline to pay for it.

A second source of privately financed and delivered basic services consists of nonprofit civil organizations. Volunteer service and "self-help" initiatives typically are both privately provided and privately financed. Residents will often join together in voluntary associations to provide a particular service to others or themselves on an unpaid basis. Although highly cost-effective, these self-help associations frequently suffer from free rider problems which can demoralize the initial activists. Accordingly, volunteer organizations are generally considered less durable service providers than others.

A third, more durable vehicle for privately financing and delivering basic services consists of self-assessing homeowners' associations. These nonprofit organizations rely upon contractual agreements, written into property titles, that obligate all propertyowners in an area to support common facilities and services. Failure to contribute one's fair share can subject a homeowner to legal action by his neighbors. Associations can thus finance and delivery a wide range of public services on a lasting basis. As discussed later in this report, some municipalities have encouraged homeowners' associations to assume greater responsibilities for community infrastructure and services.

The above policy options can be collectively referred to as methods of privatization—relying on private market entities to perform services formerly or traditionally produced by public bureaucracies, or at least mandated by government action. Such policies are much more widespread than is generally recognized. An International City Management Associations (ICMA) report revealed that in cities across the country over 59 different services are contracted out to a significant degree.[18] The ICMA study found that intergovernmental contracts and franchising arrangements were also widespread.[19] The proliferation of homeowners' associations and their achievements in delivering "public" services is discussed in Chapter II.

In summary, privatization policies can produce desirable results when they are skillfully implemented. These alternative methods can regularly produce major cost savings for state and local governments in the provision of public services. When education is included among private sector options, then at least two-thirds of local government spending and perhaps fifty percent of direct state spending goes to fund services that can be encompassed in privatization policies.[20] A clear potential exists for reductions in state and local spending.[21]

C. IMPACTS OF PUBLIC SERVICE INEFFICIENCIES

The inefficiencies of public service delivery have detrimental effects upon both living conditions and on economic activity. The adverse effects are felt both as a result of needless resource consumption, and of shortcomings in basic service provision.

1. *Effects on Living Conditions*

Inadequate, low quality public services are now all too common. Over the past two decades, despite massive spending increases, public schools have often proved unable to teach even basic skills; standardized test scores have shown a substantial decline among college-bound students.[22] Indeed, the schools are often incapable of keeping students and teachers safe from violence.[23] Crime is prevalent in major inner city areas, transit systems are often neglected, and city service maintenance is deteriorating.

Public infrastructure is also in an appalling state in many areas: a fifth of all bridges in the United States now need major rehabilitation or construction.[24] Almost 20 percent of the mileage of the interstate highway system is now beyond its planned useful life.[25] Overloaded and inefficient water and sewage treatment systems are inhibiting residential and industrial development in many parts of the country.[26]

Property values in communities rise or fall in step with public service quality. Common sense indicates that people will want to live in areas that are attractive, safe and generally well-serviced. People will be less willing to pay for property where the public services provided to that property are deficient. As a result, the market value of such property will be increased. The worse the services and the higher the associated tax burden, the less people will be willing to pay for a property, and the lower its market value will be. Where people receive full value for their tax dollar, property values will surpass those in the area where inefficient public services prevail.

Several studies support these common sense observations. In a 1956 article,[27] Charles Tiebout advanced the theory that differential land values could be used to determine consumer preferences for different amounts of public services. In another study,[28] Wallace Oates examined housing prices in 53 communities in New Jersey. He found that higher per pupil expenditures in the public schools tended to increase the value of single family homes, in cases where propertyowners received value for their tax dollar.

Probably the most comprehensive study was published in 1980 by the Urban Institute, under a grant from the U.S. Department of Housing and Urban Development.[29] This study used data from 39 large standard metropolitan statistical areas across the country in concluding that better services improve property values. Cautioning that only indirect data on the quality of local services was available, it also found a negative relationship between property values and local taxes in cities with lower reputations for service delivery.

Lower property values, in turn, translate into lower tax revenues, particularly for those jurisdictions that rely heavily on local property taxes. As we have noted, property taxes are still the largest single source of local government revenues, accounting for approximately a quarter of all such revenues nationwide. (Annex A, Table 15) Consequently, low quality, unnecessarily expensive state and local services will significantly reduce state and local revenues through negative effects on local property values.

2. Effects on Economic Growth

Inefficient public services and the unnecessarily high taxes needed to finance them stunt overall economic growth, reducing tax revenues across the board. These low quality services raise business costs by forcing businesses to purchase supplementary or substitute services out of their own funds. Governments also may be forced to pay higher wages to employees working where public services are inadequate.

These extra costs often result in lower compensating property prices and rentals for businesses, leading to lower property tax revenues. In cases where reduced property charges do not fully compensate businesses for these problems, the higher costs will weaken existing businesses and reduce the opportunities for the creation of new ones, diminishing economic growth.

Inefficient public services also retard economic growth by leading to higher than necessary taxes. Higher taxes that reduce the return to economic activity—whether labor, capital investment, or entrepreneurial activity—by definition, reduce the incentives to undertake such activity. This, in turn, holds back job creation and economic growth. State and local taxes such as individual and corporate income taxes, payroll taxes, property taxes, and even sales taxes, clearly inhibit economic prosperity.

Studies of business location decisions highlight the importance of quality public services and infrastructure, as well as taxes.[30] There is widespread agreement that public safety and transportation are foremost considerations for businesses reviewing alternative locations or expansion sites. Such findings are supported by an extensive survey of manufacturing location factors conducted by the Economic Development Administration of the Department of Commerce in the early 1970s.

Evidence regarding the effects of state and local taxes upon business location and expansion decisions is more mixed. Manufacturing firms responding to the EDA survey, for example, cited state and local tax incentives as the "most significant" location factor in less than five percent of the cases for which the number of responses per industry sector was statistically significant.[31] Such findings are open to fundamental challenge, however, on the grounds that they do not examine tax impacts on the creation of new businesses and the destruction of existing ones. As MIT's Professor David Birch has pointed out, it is through the birth and death rates of businesses over time, rather than the location decisions of established firms, that the most significant economic decisions take place.

Moreover, a recent study published by the Joint Economic Committee provides empirical confirmation that heavy state and local tax burdens do inhibit job creation and economic growth.[32] The study found that during the 1970s, states with relatively falling tax burdens had much higher growth rates than the national average; states with relatively rising tax burdens had below average economic growth.

Reviewing data in 30 metropolitan areas nationwide, the study observed that the cities with the greatest economic growth in the 1970s had much lower state and local tax burdens than low-growth cities. The high-growth cities also relied much less heavily on income and property taxes, and had less progressive tax structures overall, relying much less on progressive income taxes in particular.

Since unnecessary public spending due to government public service monopoly has been shown to be quite substantial, higher taxes are likely to result, leading in turn to the inhibition of economic growth.

Public service inadequacies, then, contribute greatly to the fiscal problems of state and local governments. Spending is sharply increased due to the inefficiencies of government-provided services. Revenues are reduced significantly due to the negative impact of public service problems on property values and economic growth. Consequently, the reduction of these negative fiscal impacts should be a central concern of state and local governments when addressing their overall fiscal problems.

D. TRADITIONAL RESPONSES TO FISCAL STRAINS

The discussion above outlines three interrelated problems—(i) the fiscal problems faced by Federal, state and local governments; (ii) the unnecessarily high cost and low quality of state and local services provided through traditional monopolistic, government bureaucracies; and (iii) the problems of high taxes, low quality services, declining neighborhoods and reduced economic growth faced by taxpayers and residents.

When examining alternative solutions to these problems, it is important to consider how each response will affect the total picture. For example, an approach that appears ideal for solving fiscal difficulties on the governmental level may adversely affect the economic situation of the taxpayers—a comprehensive effort is essential.

1. Increased Federal Aid

One solution often proposed for state and local fiscal problems and inadequate services is increased Federal aid to state and local governments. But with Federal deficits of $150–$200 billion projected indefinitely, such an approach appears out of the question. While alleviating state and local fiscal problems, it would only make intractable Federal fiscal problems even worse.

Indeed, in recent years a substantial portion of Federal budget cuts has been precisely in Federal intergovernmental aid, as discussed previously. Despite these cuts, such aid in President Reagan's proposed FY85 budget was still 11 percent of total Federal spending, over $100 billion. Given continued severe Federal fiscal problems, such aid is likely to face pressures for further cuts in the future.

Moreover, simply increasing such aid would do nothing to reduce the unnecessarily high cost of state and local services generally provided through monopolistic government bureaucracies. Given the inefficiencies of such monopolies, it may do little to improve quality as well. At the same time, the tax burden on taxpayers would possibly even be increased due to intensified demands on the Federal government.

2. Increased Taxes

Another option is increasing taxes to remedy government fiscal problems, thereby providing additional funds for services. But the present reduction in Federal income taxes is soon to be wiped out by further increases in payroll taxes. Raising taxes now would only worsen taxpayers' burdens. Tax escalation would weaken the economy and reduce revenue growth, possibly creating a need for further tax increases. Instead of solving fiscal problems, a situation could arise in which new tax revenues are fully offset by the economic decline resulting from the increases.

Furthermore, at the state and local levels, numerous tax limitations passed in recent years would probably prevent reliance on tax increases to resolve fiscal problems. Since 1977, half of the states have passed new tax or expenditure limitations and a recent survey reports that 80 percent of cities surveyed nationwide now have at least one type of limit.[33] Sixty percent of cities have property tax limits, over half already at their ceiling. In addition, sales, business and income tax limits have been enacted across the country. Approximately half of all cities also have prohibitions on income taxes.[34]

Further tax increases would again fail to address the inefficiencies and high service costs characteristic of government bureaucracies. In any event, using additional funds to solve quality problems produced by structural, institutional factors would undoubtedly be only marginally effective, as well as unfair to taxpayers.

3. Spending Cuts

Another option is to address fiscal problems through spending reductions. Although this approach has considerable political support, opportunities for further domestic spending cuts appear to be limited.[35] Significant cuts have already occurred in AFDC, food stamps, nutrition programs, housing assistance, job training, school lunches, student aid, housing finance, extended unemployment benefits and trade assistance.[36] Federal intergovernmental aid was also reduced for programs such as public service employment, community development grants, transportation subsidies and water resource projects, under policies to eliminate subsidies which distort the market economy, and to stretch out subsidies for capital projects.[37]

Independent studies have not focused comprehensively on the effect of the Federal cuts on the quality of state and local services.[38] [39] The Federal cuts typically did not affect financing of general public services. Where public services were effected, state and local governments sometimes turned to user fees to replace lost revenues for public services.[40] In other instances, however, there was a drop in service quantity.[41]

Additional spending cuts seem to be the least unsatisfactory means of resolving present fiscal dilemmas.[42] But slashing Federal intergovernmental aid further will simply intensify state and local fiscal difficulties, leaving residents with even more inadequate services. This, in turn, will further depress property values, harm neighborhoods, slow economic growth and reduce tax revenues. To avoid such damage, the shortcomings of public service delivery systems must be dealt with on a structural level, by substituting alternative service delivery mechanisms that deliver greater benefits at lesser costs.

E. Conclusion

The conceptually easy, routine solutions—increased Federal aid, tax increases, or simple spending reductions—cannot serve to address comprehensively all of the problems we have discussed. While conceivably easing selected problems, they will worsen others. An entirely new approach is needed, involving basic structural reform of current governmental institutions in ways that strengthen the self-help capabilities of communities themselves.

The optimal approach appears to be one that reduces deadweight losses in public sector service delivery systems, by transfering responsibilities for delivering services to the private sector. This approach promises to economize resources while maintaining service quality. To maximize fiscal relief, moreover, opportunities should be explored for privatizing the financing as well as the delivery of basic services, on a basis benefiting all Americans.

III. OPPORTUNITIES FOR HOMEOWNERS' ASSOCIATIONS AND NEIGHBORHOOD DEVELOPMENT ORGANIZATIONS

A. Overview

While governments at all levels face growing difficulties in functioning within their present fiscal constraints, neighborhood-level organizations are demonstrating increasing capacities to provide "governmental" services on a self-sustaining basis. This chapter seeks to define the types of neighborhood organizations found commonly in the U.S. and to detail the dramatic declines in dependency upon public services that they can generate.

Two distinct types of organizations are bringing relief to their respective areas. The first is the homeowners' association, which is capable of mobilizing all propertyowners in a neighborhood in support of common services and facilities. This type of association typically provides such services as street and park maintenance, trash collection, security, and snow removal, without cost to taxpayers.

The second type of community group—the Neighborhood Development Organization (NDO)—typically provides services such as housing, job training and counseling, and rehabilitation services to low-income residents. Until recently, most NDOs were almost entirely dependent upon government and philanthropic funding. In the past several years, however, NDOs have discovered a new source of revenue: acquisition and development of real estate in disadvantaged neighborhoods.

Prospects appear bright for both types of neighborhood organizations to assume greater responsibilities in public service delivery, with fiscal benefits for governments and taxpayers alike. Yet before such promise can be realized, fundamental limitations of the neighborhood groups must be acknowledged and overcome. Propertyowners associations, for example, often improve neighborhood conditions—but in so doing, displace low income residents as property values rise. By contrast, while NDOs may be responsive to the needs of the disadvantaged, they often lack the ability to put their operations on a self-financing footing.

As some local groups are now recognizing, however, cooperation between the two types of groups can overcome their respective limitations. Several self-help organizations have discovered that community self-sufficiency increases when the two types of groups work in concert for neighborhood revitalization. In some cases, NDOs are now maximizing revenues from their real estate development projects in inner cities by activating in tandem powerful homeowners' associations. As neighborhood safety and appearance improves, the value of NDO properties rises proportionately. The strides made by such organizations point the way to an effective new strategy for neighborhood self-sufficiency.

B. HOMEOWNERS' ASSOCIATIONS

Homeowners' associations increase the self-sufficiency of many neighborhoods today by obliging all propertyowners in the area to actively share costs of common infrastructure and services. Though the types and levels of services provided by the associations may vary greatly, street maintenance and lighting, snow removal, solid waste disposal, and even utility service are commonly offered. Associations may also provide fire protection, security, transportation and emergency medical services, all functions normally provided by local governments.

The 4,000-member Community Associations Institute estimates that about 95 percent of all homeowners' associations provide at least routine maintenance and repair of streets, grounds and parking lots. About two thirds offer some form of recreational amenities such as swimming pools, tennis courts or game rooms. A recent CAI survey also found that more than half or all homeowners' associations belonging to the organization also contract privately for trash removal. According to Douglas Kleine, executive director of the Institute, crime prevention is another service priority of homeowners' associations—more than 25 percent provide manned security services, and about 15 percent utilize electronic surveillance. The Institute reported substantially lower incidence of services in areas such as day care and mass transportation.[1]

Yearly fees accompanying membership in homeowners' associations range from $50 to $2,500. Maintenance of commonly-held areas is included in the fee, as are pro-rated expenses for service delivery. Contractual agreements which "run with the deed" mandate periodic self-assessments upon association members.

In contrast to block associations, which rely upon donated labor and nominal fees, homeowners' associations are capable of supporting public services and amenities on a lasting basis. The universal participation of homeowners in sharing burdens of self-help activities minimizes problems of "free riders"—the holdouts who normally cripple private sector efforts to deliver public services by refusing to pay their share of the costs.

Approximately 25,000 homeowners' associations are now in operation in the United States, up from about 500 in 1964. The rapid growth of homeowners' associations has come about from the ability of associations to arrange for efficient and responsive services and facilities desired by propertyowners. In contrast to remote, bureaucratic public sector institutions, homeowners' associations make special efforts to "shop around" for the service delivery arrangements most favorable to propertyowners. Each association holds title to the common areas and shared facilities, and generally engages professional, business-like contractors for maintenance and service delivery responsibilities.

Although most homeowners' associations arise as an integral part of new housing developments, they have also been successfully launched within established neighborhoods. The Waterman Place Association in St. Louis provides an example of a homeowners' association that was formed in a decaying neighborhood in response to factors such as crime and prostitution that were eroding property values and citizen morale. In 1974, more than 90 percent of the propertyowners in the Waterman Place neighborhood signed deed covenants to form a self-assessing association.

The association successfully petitioned the city government to transfer title to the roadway serving the area to the association. Not only did the association agree to maintain the street at its own expense, it borrowed the necessary funds to erect a gate to limit traffic through the area. The low- to middle-income propertyowners were able to secure financing for the neighborhood improvements because of the association's covenant-backed power to levy self-assessments for repayment. The result was a dramatic reduction in crime and a 200 percent increase in property values within 12 months. Today, property values in the neighborhood average five times higher than they were a decade ago.[2]

In the Bronx, New York, a large privately owned apartment complex housing 12,000 people underwent a similar transformation. By the late 1970s, the Glen Oaks Village development was experiencing problems of crime and physical deterioration typical of many other apartments that had passed their prime. In response, owners of Glen Oaks Village in 1980 converted the development to a cooperative, in which residents purchase shares. The cooperative established self-assessed fees to support a number of quasimunicipal functions, such as security patrols, trash collection, snow removal and repair and upkeep of streets, sidewalks and playing fields. Property values again have more than doubled since activation of the self-assessing organization.[3]

Self-assessing associations have proven effective in eliciting support for neighborhood improvements of other kinds. Many homeowners' associations require a firm commitment on the part of households—specified in their deed restrictions—to maintain their property in acceptable physical condition. If an owner fails to do so, the covenants entitle the association to enter the property, make improvements and assess the owner for the costs. If an owner refuses to pay assessments or reimburse the association for any agreed-upon service, the association can legally attach a lien against the property to ensure payment.

These powerful neighborhood self-help mechanisms can have a substantial effect upon property values. In a pioneering 1964 nationwide study of 165 homeowners' associations, the Urban Land Institute found the effect of covenant-backed associations upon the marketability of home developments was "overwhelmingly favorable." More than 90 percent of the homeowners' association officers, 83 percent of the developers, and 83 percent of the relators surveyed called the association's effects upon property values to be favorable or very favorable. None of the association officers and developers, and only two percent of the realtors, considered that the associations had negative effects; the remainder considered the effects of the associations to be neutral. The findings of the ULI report helped set off the subsequent explosion in numbers of homeowners' associations across the country.[4]

Although homeowners' associations are most commonly found in new middle or upper income residential developments, some of the most dramatic examples of their effects upon property values have occurred in disadvantaged areas. As documented by urban planner Oscar Newman in *Community of Interest,* homeowners' associations have assumed responsibilities for street ownership and maintenance in a number of areas.[5] Newman found that property values in blocks with urban homeowners' associations were six to 24 percent higher than in otherwise virtually identical blocks that lacked such associations. Most vividly, the Waterman Place Association in West Central St. Louis has attracted national media attention for its success in reversing crime and physical delapidation in the area. Within a year of the Waterman Place Association's creation in 1974, property values in the neighborhood doubled; today they are more than four times higher on average than previously.[6] Similar effects of propertyowners associations have been noted in the Washington Hill neighborhood of Baltimore; Brookside in Tulsa; and Parade Park in Kansas City, MO.[7]

The following summarizes the principal capabilities of homeowners' associations to improve neighborhood conditions, and accordingly to increase market demand for their properties:

1. Crime Prevention

Neighborhood-based security efforts range from passive "crime watch" surveillance by residents from their homes, to active security patrols. About 30,000 neighborhoods around the country conduct some form of community crime prevention activity, and results have been impressive. Estimates of the impact on local crime rates indicate reductions in incidences of 20 to 60 percent. A number of neighborhoods in Virginia suburbs of Washington, DC, for example, have reported 35–50 percent crime reductions as a result of implementing crime watch programs.[8]

Because they typically rely upon the labor of volunteers, operating costs for community crime prevention efforts are often negligible. A significant problem for voluntary efforts, however, is that block watches are not easy to sustain. After initial volunteer enthusiasm dwindles, the original activists tend to "burn out," leaving neighborhoods relatively unprotected.

Homeowners' associations face fewer problems of this sort; their universal membership provisions enable them to distribute the burdens of supporting neighborhood improvement efforts far more widely. As a result, participants in the crime watch activities need contribute far smaller amounts of time. Where association members prefer not to actively participate in block watch responsibilities, homeowners' associations have the option of requiring the nonparticipant to pay higher fees than participants to support the neighborhood crime prevention operations.

Reductions in crime rates are capitalized readily into property values. For every 10 percent reduction in crime rates, economists Mitchell Joelson and Charles M. Gray concluded in a 1978 study that the value of an average urban single-family house rose by approximately $3300.[9] This magnitude of impact was confirmed by interviews of project researchers with realtors in the Washington, DC market.[10]

2. Control of Physical Dilapidation

Cleanup/fixup activities in older neighborhoods have proven to be among the most cost-effective initiatives commonly performed by homeowners associations. By involving a significant portion of a neighborhood in comprehensive and sustainable clean-up efforts, the associations can dramatically change the image of an inner city area in a relatively short time span.

The type of cleanup/fixup initiatives undertaken by homeowners associations differs from those by conventional block associations. Because block associations rely upon volunteer efforts, they often have only temporary effects. Homeowners' associations operate on the basis of legal commitments by propertyowners to continuing upkeep. Covenants ensure that each household keeps its property in good repair and its yard free from trash or litter. In some associations a noncomplying member has only 15 days after formal notification of an infraction to remedy a maintenance problem; after that time the association may order the necessary work to correct the deficiency and charge the work to the resident. (If he or she refuses to pay for the work, a lien may be placed upon the property, which cannot be sold until the lien is removed.)

The Urban Land Institute survey of homeowners associations found that houses participating in self-assessing associations defied the standard physical life cycles of residential neighborhoods, "strikingly in contrast to the deterioration of other housing of comparable age and location." Consequently, property values of association-backed neighborhoods fared far better than did those of virtually identical neighborhoods lacking covenants to protect against physical deterioration.[11]

3. Infrastructure Maintenance and Basic Service Delivery

As privately developed neighborhoods have increased around the country, so have the responsibilities of covenant-based associations. In many instances, homeowners' associations are providing a gamut of services similar in nature and scope to those usually delivered by local governments. The process has been instigated by municipalities that require developers of subdivisions to build and pay for roads, water lines, and sewer systems. In some areas, local governments require that the infrastructure be dedicated to some areas, local government require that the infrastructure be dedicated to the municipality, but streets for private developments often become the homeowners' responsibility. Modern subdivisions also frequently include common open spaces, equipped for recreational or playground uses or landscaped simply as parks. In such cases upkeep responsibilities for those facilities naturally fall to the homeowners' associations.

Associations also arrange for private delivery of a number of "municipal" services. The most common of these are refuse collection, street lighting, snow removal, operation of recreational facilities, and, in some cases, transit and emergency services. Typically, rather than attempt to provide such services "in-house," the associations will contract with professional service providers. The ability to pick and choose among alternative contractors enables the associations to select economical and responsive providers.

Although no studies have specifically focused on the relative efficiency of homeowner association-financed infrastructure and service delivery relative to comparable public sector services, there are compelling grounds for believing that the cost savings must be substantial. Theoretical and empirical findings regarding private versus public service delivery, reviewed in Chapter II, indicate that public sector bodies typically operate less efficiently than their private counterparts. Moreover, the rapid growth of homeowners' associations in recent decades would have been unlikely to occur unless association infractructure and basic service arrangements were more attractive than those available to homebuyers elsewhere.

4. Limitations of Homeowners Associations

Homeowners' associations in their present form seem well suited for increasing the self-sufficiency of middle income and upper income neighborhoods. In addition, they are effective in reducing crime, blight, and problems with inadequate service delivery in disadvantaged areas. But homeowners associations have a fundamental limitation: the gains from their neighborhood improvements accrue almost exclusively at present to propertyowners themselves.

More than simply ignoring the interests of the poor, homeowners associations in some settings can be actually damaging to them. The rises in property values created by successful neighborhood improvement efforts in disadvantaged neighborhoods often precipitate large-scale outflows of existing low-income residents. Displaced tenants have no means of benefiting from the revitalization of their areas.

C. NEIGHBORHOOD DEVELOPMENT ORGANIZATIONS

In contrast to homeowners' associations, Neighborhood Development Organizations have as their purpose assisting disadvantaged citizens of a community. Their services may be highly targeted upon specific subgroups (e.g., senior citizens or handicapped persons), or geographically oriented toward assisting all low-income residents of a depressed area.

NDOs, unlike homeowners' associations, almost never rely for the majority of their support upon dues collected from propertyowners in a given neighborhood. Instead, Neighborhood Development Organizations usually depend upon institutional funding. The most common contributors to NDOs have included local, state and federal programs, as well as contributions from private foundations. With resources from these sources, NDOs have in many cases been able to assemble paid, full-time professional staffs to oversee delivery of needed services.

Cutbacks in traditional funding sources have prompted Neighborhood Development Organizations in recent years to turn increasingly to revenue-generating activities as a means maintaining services and programs. The most important new revenue-generating source consists of real estate development. Neighborhood Development Organizations have begun to generate incomes by acting as developers, managing partners, limited partners, creditors or simply as shareholders in inner city property development projects. The types of property that can be developed include residential (both single- and multi-family), commercial, and industrial holdings.

The association's goals, size and capabilities influence the kinds of property that it purchases or manages. For example, some organizations may want to assure the ongoing stability of the housing stock in its neighborhood, and may invest in residential property for that reason. Other NDOs may have a greater interest in increasing the local pool of job opportunities, investing in industrial or commercial property to further this goal. Several NDOs are now reaping $200,000 to $400,000 annually from their real estate projects alone; income from such new revenue sources enables the organizations to maintain services that would otherwise be lost to their communities, or paid for by taxpayers.[12]

NDOs have proven particularly successful in providing labor-intensive services in a non-bureaucratic and less-intimidating manner than government agencies to their clienteles. Examples include:

1. Increasing the Availability of Low-Income Housing

More frequently than perhaps any other service, NDOs concentrate upon increasing the supply of affordable housing in low-income areas. These initiatives take a variety of forms, including operation of revolving loan programs for renters to purchase homes, provision of property management services, and acquiring and rehabilitating run-down buildings. Some NDOs, such as the Mexican-American Unity Council of San Antonio, have formed commercial subsidiaries to undertake construction of the projects. Increasingly, NDOs are developing market-rate (unsubsidized) properties in conjunction with provision of housing for the disadvantaged. Profits earned by the market-rate projects enable the organization to expand its housing programs for low-income residents. In addition to promoting financial self-sufficiency for projects that would otherwise demand public sector financing, this approach serves to integrate communities economically and socially. It is also an effective way to minimize or prevent displacement of low-income residents as neighborhood conditions improve.

2. Social Services

Some NDOs provide neighborhood-level social services for disadvantaged residents, including job counseling, food and health programs, counseling and mental health services, day care, adoption referrals, and alcohol and drug rehabilitation assistance. In many cases, such services are funded by grants or contracts from governmental bodies. As such funding sources diminish, however, NDOs have turned progressively toward "fee for service" and other revenue-generating approaches.

Relative to public sector bodies engaged in similar activities, NDOs are more sensitive and flexible in responding to the needs of their communities. The rigidities of civil service procedures and attitudes tend to be less evident among the NDO service providers. In addition, low-income residents often feel more comfortable in dealing with a "grass roots" level organization, rather than with more remote and bureaucratic agencies of municipal, state, and/or federal government.

3. Job Training

Another form of assistance effectively provided by NDOs, both formally and informally, concerns work skills development. Because NDOs are closer to their communities than many traditional public sector manpower programs, they tend to fare better in job training, referals, and work attitude orientation. The responsiveness of such NDO programs to the needs of the market place has increased in recent years, with the declining availability of funds from the public sector. Today, NDOs active in work-related programs have turned to businesses for partial funding support of such programs. In consequence, the organizations have become oriented to the needs of employers as well as those of the unemployed.

4. Limitations of NDOs

Despite their successes in many areas, Neighborhood Development Organizations to date have come nowhere near to achieving their potential. They are handicapped above all by a lack of financing. Although NDOs have become far more business-like as a result of adaptations to public sector spending cutbacks, their opportunities at present for becoming financially self-sufficient appear to be inherently limited. Some have tried to meet their funding needs by charging clients for their service. But trying to assist the disadvantaged on a fee-for-service basis is inherently self-defeating; the clientele is generally impoverished. NDOs have had more success with generating revenues for property development, and there remains plenty of abandoned property in inner cities available for transfer to NDO ownership. Prospects are bleak for adequate earnings from this source, however, so long as problems with crime, blight, and inadequate public services remain formidable.

D. COOPERATION BETWEEN HOMEOWNERS' ASSOCIATIONS AND NDOs

Both types of organizations described in this chapter provide valuable contributions to their neighborhoods and/or coummunities. Yet neither, alone, is capable of generating the full range of needed benefits for economically distressed neighborhoods.

Several NDOs have begun to demonstrate that cooperation between NDOs and associations of property owners is feasible. Two Missouri-based organizations, the Union-Sarah Economic Development Corporation, Inc. and the Blue Hills Homes Organization, have demonstrated that differing types of neighborhood groups can play complementary roles in neighborhood revitalizations.

1. Union-Sarah Economic Development Corporation

Established in 1969, the St. Louis based Union-Sarah Economic Development Corporation is recognized as a pioneer of income producing real estate projects for community improvement. It has shown that establishing homeowners' associations in conjunction with NDO property developments can considerably reduce problems of crime and blight, thereby improving the marketability of its developments.

The corporation—a for-profit enterprise owned by Union-Sarah Community Corporation, its nonprofit parent group—obtained its initial resources entirely from federal, state and local funding. The major contributors included the Missouri Housing Development Corporation, the Federal Office of Economic Opportunity, the Department of Commerce's Economic Development Administration and the Community Services Agency. During the fiscal year 1972-73, these public sector funds amounted to a peak of $1.2 million.

The organization invested these funds to a large number of Union-Sarah owned business enterprises, including tool rental services, grocery stores, and even teflon cookware retail outlets. However, the demands of continuously managing retail operations proved unexpectedly great thus forcing Union-Sarah to close down its business operations by 1975. Unsuccessful at business development, Union-Sarah turned its efforts to property development. This focus soon proved very successful and now represents a core of the organization's revenue base.

Union-Sarah's property development projects consisted first of residential housing development. Union-Sarah initially developed 66 units of market-rate rental housing in a fringe, stable area. The project—although slow in starting as a result of Union-Sarah's inexperience—within several years began earning significant profits. Subsequently, Union-Sarah moved into large-scale rehabilitation of rental housing. It purchased city owned properties at a discounted rate of $10 per square foot; the properties are at present worth three to four times their original value. Today, Union-Sarah has ownership interest—ranging from 40 to 100 percent—in 550 units of housing in the area.[13]

Classic inner city deterrents to successful property development have been effectively dealt with by Union-Sarah. One of its major residential developments was located in district with the second highest crime rate of the community; the neighborhood also had problems with dilapidated and boarded-up buildings. After establishing a condominium-style propertyowners' association in the development, however, the neighborhood has become the safest in Union-Sarah's part of St. Louis. Property-upkeep stipulations in the developments deeds have also contributed to the takeoff of the neighborhood.

Income earned from these property developments, amounting to $400,000 in 1982, today enables the Union-Sarah Economic Development Corporation to operate on a fully self-sufficient basis, without the red tape and paperwork delays entailed by public sector funding. The profits it attains are directly and indirectly used to benefit the low income residents of the area.

2. Blue Hill Homes Corporation (Kansas City, MO)

The Blue Hill Homes Corporation (BHHC) is a Neighborhood Development organization that provides a range of social services to disadvanteged residents of Kansas City, Missouri's southeast side. Chartered in 1974, the organization hired its first employees two years later when it became involved in housing rehabilitation. During its initial years, most of BHHC's revenues came either from the Department of Housing and Urban Development or a local private foundation. It also received funds from the Law Enforcement

Assistance Administration to organize crime-fighting neighborhood block watches.

In more recent years, cuts in traditional government funds have prompted BHHC to adopt a more self-sufficient strategy. It now operates a multifaceted program to generate revenues from non-governmental sources, especially from real estate development. Blue Hills first became active in real estate related projects in 1976, when it began rehabilitating homes under HUD's Section 312 program. Its housing rehabilitation efforts at present are largely financed through HUD rehabilitation loans, Missouri Housing Development Commission bonds and the Kansas City Rehabilitation Loan Corporation. BHHC now owns and manages 60 rental units, with plans to acquire another 50 units in the near future. An additional 60 to 70 units have been rehabilitated and sold outright in the past 24 months alone. The total net revenues from these actions are approximately $300,000–$350,000 a year.

BHHC also recognizes the role that residents of the neighborhoods can play in improving the marketability of its properties. In its effort to improve the conditions of the poorer neighborhoods, BHHC has actively encouraged the formation of block-level associations. About 50 such block clubs have been formed, helping to reduce the local crime rate and to cleanup/fixup the area. As with Union-Sarah, revenues that result from the improved neighborhood investment climate are in turn applied to services benefiting low-income individuals.[14]

The experience of such organizations illustrates the complementarity of functions between Neighborhood Development Organizations and associations of propertyowners and/or residents. Homeowners' associations (and strong block associations) can raise property values by mobilizing residents effectively against crime and blight, at no cost to taxpayers. By acquiring and assembling underutilized inner city properties in advance, NDOs can benefit financially as homeowners' association initiatives send real estate values soaring. Increased revenues from the NDO property holdings can then be used to support services of direct benefit to low-income residents. In sum, mobilizing homeowners' associations promises to increase the marketability of NDO property development projects, and hence the flow of revenues to services benefiting the disadvantaged.

This new framework for cooperation offers the prospects of increased fiscal dividends from neighborhood self-sufficiency in rich and poor communities alike. Homeowners' associations are able to assume many traditional municipal services responsibilities at substantial savings to the public sector. Simultaneously, demands for social services can be minimized through the generation of significant revenues by Neighborhood Development Organizations.

IV. CHALLENGE GRANTS—A TOOL FOR STRENGTHENING COMMUNITIES

This chapter describes a strategy for strengthening neighborhood self-help capabilities. The first section examines a way to combine the capabilities of homeowners associations and Neighborhood Development Organizations, in a manner that maximizes fiscal dividends for the public sector in low-income as well as middle-income neighborhoods. Following this discussion, the chapter explores methods for stimulating creation of such hybrid organizations through use of private and/or governmental "challenge grants."

A. Enhancement of Neighborhood Group Capabilities

As noted in the preceding chapter, two basic types of neighborhood organizations bring distinctly different strengths and weaknesses to the task of promoting community self-sufficiency. Homeowners' associations can mobilize sufficient resources to make middle and upper income neighborhoods far less dependent upon government services, but they fall short in meeting the needs of low-income tenants. NDOs, conversely, are well suited for assisting the disadvantaged, but lack strong internal revenue-generating mechanisms.

One powerful approach to maximizing fiscal benefits from neighborhood self-help consists of building links between homeowners associations and NDOs in distressed areas. Recognizing the capability of homeowners associations to revitalize neighborhoods, NDOs can position themselves to benefit financially from the ensuing increase in property values. Before homeowners' associations are formed in distressed areas, NDOs can acquire abandoned and/or underutilized properties at depressed values. Subsequently, with the onset of cleanup/fixup and crime prevention efforts, the Neighborhood Development Organizations can lease or sell off their real estate at substantially appreciated values, and direct the proceeds to services that benefit the disadvantaged.

A second promising approach consists of establishing hybrid organizations that combine in one body the respective strengths of differing types of neighborhood groups. In essence, this new generation of neighborhood groups would consolidate the techniques now employed separately by homeowners associations and NDOs. The resulting organization—referred to hereafter as neighborhood "enterprise association"—would benefit propertyowners and renters alike.[1] The public sector under this approach benefits from transfers of service responsibilities to the associations, and from reduced consumption of social services by low-income residents.

Basic to the enterprise association approach are deed-based covenants, similar to those used in tens of thousands of homeowners associations for mandating active membership by propertyowners in a neighborhood. In contrast to most propertyowners' associations, however, the covenants of the enterprise association would offer opportunities to tenants to benefit from neighborhood self-renewal—provided that tenants actively participated in neighborhood cleanup/fixup and crime prevention efforts, which can add substantially to neighborhood property values. Governments at all levels would gain fiscal dividends through expanded self-sufficiency of neighborhoods.

The following discussion amplifies on the two distinguishing features of neighborhood enterprise associations:

1. Ability To Mobilize Propertyowners

In contrast to conventional Neighborhood Development Organizations, an enterprise association would emphasize mobilization of propertyowners. Deed-based covenants would oblige propertyowners to participate in a self-assessing association with their neighbors. As noted in the preceding chapter, such covenants generally stipulate that propertyowners contribute money or time on a regular basis in support of association-specified neighborhood improvement initiatives that benefits all.

Mobilization of propertyowners through deed covenants appears to be feasible in a range of settings. Middle and upper income neighborhoods are among the most potentially receptive areas to the association approach, by virtue of their established civic skills. Low-income neighborhoods, however, also may have distinct advantages because ownership of properties is often concentrated in a relatively few hands. Blocks with a small number of landlords, in contrast to blocks with a larger number of single family homeowners, would experience fewer "transaction costs" in establishing a self-assessing association. Moreover, the appreciation of property values as a result of association activities (notably crime prevention and cleanup/fixup) will normally be more pronounced in low-income settings than elsewhere.

2. Ability To Share Benefits With Renters

In low-income areas, neighborhood enterprise associations can overcome a frequent weakness of homeowners' associations by sharing benefits directly with tenants. Traditional homeowners associations have often adversely affected low-income tenants in the course of improving the investment climate and living conditions of distressed neighborhoods. As indicated earlier, homeowners associations in some economically depressed areas have doubled or even tripled property values within short periods by improving neighborhood safety and appearance. Displacement of low-income renters often accompanies such a rise in property values.

A neighborhood enterprise association can convert rising property values from a problem to a gain for low-income renters. The enterprise association approach provides that all who take an active part in improving neighborhood conditions should share in the financial benefits resulting from the improvements. In many areas, for example, renters who cooperate with neighborhood crime watches and cleanup/fixup efforts on a sustained basis have the potential to add tens or hundreds of thousands of dollars to property values on a block. It is in the interest of propertyowners to encourage renters to take actions that raise the value of their properties, even if some of the windfall is to be shared.

Several options exist for enterprise associations to share financial benefits with renters who contribute to improvement of the neighborhood:

i. Agreements to minimize rent hikes.—One proven approach is a voluntary agreement that provides protection from rent hikes; tenants who cooperate in improving the neighborhood (and hence in adding to the landlord's property values) can be offered protection against rent increases. Private agreements between landlords and tenants have contributed substantially to the revitalization of Soho in New York City. The arrangements usually rely upon substantial "sweat equity" by the tenant in fixing up dilapidated properties.[2] In return for this investment of time, the tenant receives from the landlord a long-term (often 10-year) lease with guarantees of below-market rental rates. Similarly, municipalities can act to safeguard the interests of low-income residents who join in neighborhood improvement efforts. Yonkers, New York has developed a program that protects tenants from normal rent hikes, in return for tenant cooperation in cleaning up stairwells and grounds. For landlords agreeing to soften rent increases for such tenants, the city reduces enforcement of petty regulations.[3]

ii. Equity interests.—Another approach—particularly applicable in distressed areas—would be for the association to obtain nearby governmentally-owned properties, and share the proceeds from their sale or lease with individuals who helped make the area safer and more attractive. In such cities as St. Louis and Kansas City, Missouri, community-based organizations in recent years have acquired substantial parcels of vacant or under-utilized public lands. These properties, once developed, have generated revenues for services of benefit to the poor.[4] The revenues generated by the property developments, moreover, increase to the extent that the community based organizations are effective in mobilizing individuals to participate in crime prevention and cleanup/fixup activities.

iii. Set-asides.—A third approach is to set aside a portion of the propertyowners' self-assessed fees to compensate tenants who participate in association-sponsored improvement efforts. Volunteers in neighborhood cleanup/fixup or crime watch efforts, for example, might be compensated for the time they invested in such activities. A variant of this technique is found in Columbia, Maryland's homeowners' association. Tenants who spend part of their time as gatekeepers or groundkeepers are entitled to cost-free access to indoor and outdoor recreational facilities of the association.

The above mechanisms are practical, proven techniques for safeguarding the interests of tenants as neighborhood conditions improve. By ensuring that tenants receive "a piece of the action" in appreciated property values, proportional to their participation in initiatives that improve the investment climate, tenants and propertyowners alike can benefit from the establishment of strong self-help organizations.

From the standpoint of public sector institutions, enterprise associations clearly have the potential to make positive fiscal contributions. The neighborhood enterprise association approach can most immediately generate cost-savings for at the municipal level; local governments can divest themselves of service responsibilities such as street and park maintenance, refuse collection, snow removal, and daycare as associations take root. Fiscal benefits for local governments, however, would go beyond cost-savings from divestiture of public services. To the extent that local governments derive revenues from property taxes, the associations would be able to improve municipal finances over the course of several years by considerably raising the assessed value of properties.

For federal and state governments, benefits would accrue no less substantially. As demands for public expenditures waned at the neighborhood level, relief could be felt in federal and state spending programs. Services such as transportation, remedial education, and social programs, for example, now rely heavily upon federal and state funding. These services all have the potential to be "privatized" in whole or in part as neighborhood enterprise associations take hold. In addition, at both the federal and state level, the effects of diminished municipal outlays would generate direct benefits for federal and state tax revenues. Federal and state treasures now lose tens of billions of dollars annually from taxpayer deductions of local tax payments. (More detailed estimates of fiscal impacts are presented in Chapter V.)

B. Challenge Grants To Stimulate Neighborhood Self-Help

The public and private sectors can catalyze formation on a broad scale of neighborhood associations with the above characteristics. Perhaps the most effective means of doing so consists of offering incentives for propertyowners, on a block-by-block basis, to join covenant-backed associations.

"Challenge grants" to neighborhoods have special potential to trigger the desired response. In philanthropy, challenge grants are donations made contingent upon commitment of matching resources from other sources. As applied to neighborhood enterprise associations, a challenge grant would be given at such time as a majority of a block's propertyowners formed a covenant-backed association that obliged its members to support improvement efforts of benefit to all. An association would qualify for the grant by demonstrating a critical level of membership in a self-assessing, covenant-backed agreement.

Unlike philanthropic challenge grants, those offered to neighborhood enterprise associations can generate dividends for the giver as well as the receiver. The following section indicates how governments and private businesses might find it to their advantage to provide challenge grants for formation of strong neighborhood self-help organizations.

1. Public Sector Challenge Grants

The public sector can provide a powerful stimulus for the emergence of neighborhood enterprise associations. Four basic categories of public sector challenge grants are reviewed below: grants of tax relief, grants of public property, grants of service contracts, and grants of public funds. All of the options presented here appear practicable for use by federal, state, and/or local governments desiring to strengthen neighborhood self-sufficiency in the near term.

Each of the proposed public sector challenge grants would be designed to leave the sponsoring government with a net fiscal gain. The size of public sector grants would be determined by the size of the savings generated by a neighborhood enterprise association for a given level of government. Increasing the size of the challenge grant in proportion to a neighborhood's reduction in public service dependency would motivate associations to achieve maximum possible self-sufficiency. While most of the cost-savings could be passed on to the association, governments would retain a share as their net profit from service divestiture.

In distressed areas, another important factor should weigh heavily in disbursements of public sector challenge grants: the extent to which a neighborhood association has safeguarded interests of disadvantaged residents. As noted earlier, the creation of homeowners' associations in distressed neighborhoods may stimulate increases in property values to the point of displacing low-income residents. Recent research findings suggest that gentrification works little hardship upon transients and others who feel little attachment to their communities.[5] For more settled low-income families, however, displacement can be a wrenching experience. To minimize gentrification of low-income tenants who wish to take part in the neighborhood's revival, it behooves public sector bodies to disburse their challenge grants on a basis favoring associations that include tenants in the benefits of revitalization.

I. GRANTS OF TAX RELIEF

Governments can provide challenge grants of tax relief that stimulate formation of neighborhood enterprise associations. Three primary tax incentive options are discussed below.

(a) Eliminate discrimination in deductibility

Under the current federal and state tax codes, members of self-assessing associations are unable to deduct any portion of their fees when calculating income tax liability—even when the fees go to support local services that would demonstrably otherwise be provided by the municipality. Granting at least partial deductibility for self-assessed fees would be an important step in strengthening neighborhood self-help capabilities. The fiscal argument for such an incentive rests upon the ability of propertyowners' associations to deliver services more economically than public sector organizations. Accordingly, aggregate local service expenditures would be restrained as neighborhood enterprise associations grew in number and responsibilities. For federal and state governments, deductibility could be justified on grounds of reduced overall taxpayer deductions for the cost of local services.

Such a deduction can be justified to the extent that an association's activities fit within the range of functions normally provided by tax-financed bodies. As noted in Chapter III, propertyowners' associations have proven capable of providing virtually the full spectrum of services ordinarily delivered by municipalities. In addition, however, the associations often undertake activities—such as exterior maintenance and operation of private recreational facilities—that inure directly to the personal benefit of members rather than the general benefit of the community.

The Internal Revenue Service, in three revenue rulings on the tax-exempt status of propertyowners associations since the early 1970s, has attempted to come to grips with the issue of public versus private purposes of associations. Its first ruling (72-102 in 1972), noted that propertyowners associations were "administering and enforcing covenants, and owning and maintaining certain non-residential, noncommercial properties of the type normally owned and maintained by governments"—in short, that they were "serving the common good and general welfare of the people . . ." In 1974, the IRS reversed its direction in a second revenue ruling (74-99) that focused upon the non-public aspects of propertyowners associations. In this ruling, the IRS argued that the geographic area must have a "reasonably recognizable relationship" to an area normally considered a governmental unit or district, that the association must avoid responsibility for exterior maintenance of buildings (on the grounds that this inures to private benefit of owners), and that common facilities owned by the associations be open to the general public. A third clarifying ruling in 1980 (80-63) reaffirmed the importance of the general access and use of common areas as a test of an association's civic purpose. It also confirmed that a propertyowners association could be treated as a civic group if it established a separate organization to own and maintain limited-access facilities.[6]

The message of the IRS rulings is clear: a propertyowners association demonstrates a public purpose to the extent that it avoids responsibility for exterior maintenance of homes, and to the degree that its common facilities are open to the broader community. Accordingly, a tax policy that extended deductibility to homeowners' association fees might apply similar criteria. Member fees in a neighborhood enterprise association could be made deductible in proportion to the association's expenditures on open vs. restricted access facilities, provided that no portion of the fees went toward exterior maintenance. To ease problems of ensuring compliance with this measure, the IRS might implement such a severe penalty for violation that associations would err on the side of caution.

In 1983, a bill was introduced in the Virginia legislature to offer tax deductible status for self-assessed fees paid by members of propertyowners' associations. It called for a state income tax deduction "equal to the amount of dues or fees, excluding user charges, paid annually by the taxpayer to certified homeowner organizations." To qualify, the dues and fees were to be a minimum of $100 per year, and at least half of the homeowner organization's budget were required to be spent on alternatives to public services, including trash, leaf, or snow removal; street and parking lot maintenance and construction; water and sewer services; mass transit; outdoor illumination; and maintenance of common grounds. Although legislation was not enacted in 1983, hearings on the bill drew wide support from associations and generated substantial publicity.[7]

(b) Reduce double payments

A severe obstacle hindering neighborhood self-help associations is the problem of double payments. The overwhelming majority of homeowners' associations are now confronted by the need to pay twice for basic services—once through taxes, and again through self-assessed fees. The double payments problem not only hinders existing associations from assuming greater service responsibilities, but it deters countless other neighborhoods from even considering formation of homeowners associations as a live option. Were governments to offer relief from the double payment problem, propertyowners associations could considerably expand the scope of their operations.

At the local level, the problem of double payments has been partially resolved in at least two communities. In Houston, Texas and Kansas City, Missouri, self-assessing associations that arranged for private refuse collection received "rebate"-like payments from the city corresponding to the amounts that the city would otherwise have had to spend on servicing the area. In the past six years, the number of associations opting for the rebate in Houston has risen ten-fold, indicating a significant willingness on the part of neighborhood associations to assume service delivery responsibilities if the problem of paying twice (once through taxes, once through fees) is ameliorated.[8]

The principal difficulty in implementing tax deductions or rebates is to determine their legitimate value. At present, few governmental bodies have sophisticated accounting practices that enable them to track the true costs of delivering public services to given areas. Consequently, it is difficult for them to enact tax incentives that are finely tuned to governmental expenditures in an area. The simplest formula for setting the amount of tax deductions/rebates may be to identify the service delivery costs for the whole community, and set the value of the deduction or rebate on a pro rata, per capita basis. Such an approach, however, would penalize geographic areas and population groups that consume disproportionate amounts of public services. In the interests of establishing a more just formula for the tax deductions or rebates, residents of such areas might become allies of efforts to improve the cost accounting practices of governments at all levels.

(c) Provide new tax relief for contributions to neighborhood groups

Another possible incentive to encourage the formation of enterprise associations would be to institute, on a more widespread basis, the "neighborhood assistance program" (NAP) tax credits that have been adopted in eight states. Since NAP was pioneered in 1967 by Pennsylvania, state governments have sought to encourage contributions by businesses and individuals to neighborhood groups in economically distressed areas.[9]

Typically, NAPs offer corporations a 30 to 70 percent tax credit on the value of contributions made to eligible neighborhood organizations in distressed areas. To qualify, the corporation must provide cash or in-kind services (equipment, loaned personnel, etc.) to community groups in disadvantaged areas that are engaged in neighborhood improvement efforts. Among the types of activities undertaken by community groups with donations generated by NAPs are housing rehabilitation, community crime prevention, day care centers, alcohol and drug counseling, senior citizens centers, health clinics, and weatherization/energy conservation projects.

A federal version of the Neighborhood Assistance Program tax credits might lend a powerful impetus to enterprise associations in disadvantaged areas. By offering federal tax credits to corporations that assisted neighborhood enterprise associations, initial funding problems for the associations could be greatly ameliorated. The stronger enterprise associations become in economically depressed neighborhoods, the greater will be the self-sufficiency of their residents and the fiscal benefits to governments.

II. GRANTS OF PUBLIC PROPERTY

A second basic form of public sector challenge grant consists of offering ownership interests in idle or under-utilized government property to neighborhood enterprise associations. In recent decades, federal, state and local governments have acquired vast holdings of real estate. Although no precise estimates are available regarding the amount of idle, but developable properties, opportunities clearly exist for a substantial real estate "challenge grant" program.

States such as Kentucky and Texas have recently enacted legislation that provides for the transfer of state and municipally-owned real estate in enterprise zones to neighborhood enterprise associations. Under the terms of the Kentucky act, for example, all such idle properties are to be leased to NEAs for 99 years for $1. The NEAs in turn may develop or sublease the properties, sharing income from their properties with residents of the area. To qualify as a shareholder in the proceeds, residents must have lived in the area in question for at least one year.[10]

At the local level, the City of New York has pioneered an effective property transfer program operating on a challenge grant basis for residents of low-income areas. Its Tenant Interim Lease and Community Management Programs embody the essential ingredient of challenge grants: they turn over city-owned buildings to tenant cooperatives once the tenants agree to commit resources of their own to the building.

Under the programs, the city makes its offer of transferring ownership conditional upon membership of at least 60 percent of the tenants in a cooperative association. Membership in the association brings several obligations: a one-time purchase price of $250 per tenant, and an agreement to pay the cooperative's maintenance fees. These maintenance fees are shared equally among the coop's members, to meet the costs of building upkeep and repair.[11]

Once the tenants of a building have made their commitments, the city transfers title to the building and the land upon which it rests. Since initiation of the program in 1978, more than 100 city-owned buildings have been transferred to tenant ownership. These buildings are now back on municipal tax rolls.

With such examples as a guide, governments can develop a challenge grant program capable of stimulating neighborhood propertyowners and residents to form strong self-help associations. As indicated in Chapter III, neighborhood associations have powerful abilities to affect the value of real estate, through crime prevention and cleanup/fixup efforts. Governments divesting idle properties in distressed areas give up nonproductive assets with depressed values; in the hands of effective neighborhood associations, the properties can become substantial revenue generators for community development.

III. GRANTS OF SERVICE CONTRACTS

A third major category of public sector challenge grants consists of the prospect of contracting out selected governmental services to neighborhood associations. In recent years, awareness has grown in all levels of government that neighborhood organizations enjoy some comparative advantages in service delivery. Areas of greatest interest in contracting of services have included crime and arson prevention services, job training, early childhood education, remedial education and tutorial services, health care, housing rehabilitation, in-home care of the elderly, family counselling, transportation services, nutritional programs, street and sidewalk repair, park maintenance, refuse collection, sidewalk maintenance, code enforcement, and management of recreational centers.

Experiences of service delivery contracting to neighborhood organizations have been mixed. According to the National Association of Neighborhoods, in a recent HUD-financed study published by the International City Management Association, the shift to neighborhood contracting has yielded benefits in service cost-effectiveness, responsiveness, and effects on neighborhood revitalization.[12] Examples of cities successfully implementing the approach included Lincoln, Nebraska; Rochester, New York; and Louisville, Kentucky. Where contracting ventures have proven less successful, their shortfalls appear to be a result in large measure of the neighborhood organizations' lack of business and management skills—and their incapacity to mobilize significant resources on a continuing basis from neighborhood residents. Voluntary-membership associations rarely enlist more than a fourth of the households in neighborhood improvement projects; more frequently, members amount to between five and ten percent of the households in the area. Consequently, free rider problems have plagued efforts by neighborhood organizations to improve neighborhood conditions. Even where the size of the service contract adequately compensates neighborhood organization personnel, problems can arise over the question of the organization's legitimacy in the view of most residents. Nonparticipants often tend to be suspicious toward those who are active.

By making awards of service delivery contracts conditional upon formation of a neighborhood enterprise association (or comparable broadly-based membership group), prospects would brighten for successful neighborhood contract service delivery. Such service contract "challenge grants" could help mobilize propertyowners to contribute their own resources to the efforts in question. Equally important, the broad membership base of the organization would provide further safeguarding of the accountability and legitimacy of neighborhood contacting activities to those who lived in the area.

IV. GRANTS OF PUBLIC FUNDS/IN-KIND RESOURCES

A fourth major opportunity for public sector challenge grants consists of revising disbursement criteria for public funds and in-kind resources. As noted in Annex A, the federal government alone will disburse in Fiscal 1985 approximately $6.8 billion in general revenue sharing, $4.0 billion in Community Development Block Grants and UDAG, $5.3 billion in social services grants, and $6.8 billion in housing assistance. Revising the disbursement criteria for such funds could prove instrumental in the creation of strong self-assessing neighborhood enterprise associations.

For example, the formula under which the revenue sharing program operates can be changed to favor governments which adopt pro-association service delivery policies. The revenue-sharing formula at present is based partially on tax effort and on the relative amounts of taxes raised by different levels of government. Each dollar of taxes rebated to a neighborhood enterprise association for service delivery responsibilities could be counted twice in determining tax effort, and total taxes raised for the revenue sharing formula.

The formula for Community Development Block Grants (CDBG) could be similarly changed. This formula is partially based on populations and numbers of citizens in poverty. Each citizen in a neighborhood where an association has taken over at least one major state or local public service could be counted twice for the population count. If the citizen is poor, he could be counted twice in the poverty count.

Finally, neighborhood enterprise associations seeking to take responsibility for service delivery should be favored recipients of Urban Development Action Grants (UDAG), as long as the associations are in UDAG-eligible areas. One criterion for a UDAG is the impact of the proposed project on the economic, fiscal, and physical conditions of the community. An enterprise association should receive high marks here, because of its potential to improve the economic development climate of the area, relieve governments of costly service provision responsibilities, and to share benefits from real estate development projects with disadvantaged residents of the area. Another criteria in UDAG awards is the entent of assistance offered the project by the state or the sponsoring municipality; tax rebates to associations for service delivery responsibilities should count as such assistance, whether from state or local governments. Other criteria relating to neighborhood service delivery could also be added to the list of consideration. Such criteria include the extent to which the project will enhance the quality or efficiency of local services, or the degree of broadbased community involvement in the project.

At the state and local level, comparable opportunities exist for altering disbursement formulas for public funds and in-kind resources (such as targeted infractructure and service improvements) to neighborhoods adopting enterprise association covenants. States such as Massachusetts, New Jersey, and New York have traditionally channelled funds to qualifying community-based organizations. Similarly, localities support a wide range of neighborhood organizations by grants. Revisions in the grants-disbursement processes of state and local governments could lend a strong further stimulus to neighborhood self-sufficiency.

2. Private Sector Challenge Grants

Near-term opportunities exist for two industries, the insurance industry and the realty industry, to offer challenge grants to neighborhood enterprise associations on a profit-making basis. In essence, an insurance and/or realty firm would offer the challenge grant on condition that a neighborhood adopt strong self-assessing covenants—and that it agree to purchase services from the donating business on a group basis. The following discussion reviews how the challenge grant approach might operate on terms benefiting the neighborhoods, the companies, and the governmental bodies in question.

I. INSURANCE INDUSTRY CHALLENGE GRANTS

Insurance companies receive more than $10 billion annually in premiums for homeowners insurance policies. Such policies typically protect homeowners against damage to structures from such events as fire, storms, vandalism, and water leakage. At present, more than 90 percent of such policies are written for individual homeowners rather than groups of owners.[13]

Over the past 15 years, however, the number of group (or "blanket") policies has grown dramatically, in step with the formation of condominiums and housing cooperatives that purchase policies covering all members. Condominium and cooperative associations purchase a single policy to safeguard all units, and bill the pro rata costs to homeowners. In recent years, homeowners associations in Illinois and Pennsylvania have begun to follow the lead of condominium and cooperative associations by purchasing insurance on a group rather than individual basis.[14]

Challenge grants from insurance industries could accelerate the trend toward group purchase of insurance policies. To make a challenge grant offer, an insurance broker or underwriter would simply pledge a sum—perhaps from $200 to $500—as mobilization money for new neighborhood enterprise associations. The sum would be provided to any block association, provided it meets at least two conditions:

(*a*) A threshold percentage (50 to 100 percent) of the propertyowners on a given block accepts covenants to support initiatives (e.g. crime prevention, cleanup, cleanup-fixup, etc.) that improve the neighborhood and raise property values; and

(*b*) The enterprise association agrees to purchase a (limited term) blanket insurance policy for its members, as individual homeowners' insurance policies expire.

From the standpoint of neighborhood residents, multiple benefits would accrue from accepting such a challenge grant. By forming a strong self-assessing association, propertyowners could undertake more effective efforts to improve neighborhood conditions and raise property values. The challenge grant would provide initial seed capital to support such efforts. Moreover, savings to homeowners from group rather than individual insurance would be substantial—ranging from $50 to $100 a year. If associations were willing to accept higher than normal deductibles (such as $500 or $1000) and to self-insure for the difference, savings could be far greater.

A further advantage of a group policy for residents is that homeowners benefit from reduced vulnerability to the problem of un- or under-insured neighbors. If fire or another disaster strikes a neighbor's home, the property values of all in the neighborhood may suffer because of the individual's inability to afford repairs or rebuilding.

Compelling financial benefits would also accrue to the insurance broker or underwriter providing the challenge grant. By allowing companies to reduce the costs of signing up individual clients, the challenge grant approach enables firms to operate more profitably. Two further benefits for insurers follow from the establishment of effective neighborhood associations. First, property values respond to community crime prevention and cleanup/fixup efforts: strong neighborhood crime watches are considered among the most powerful means of deterring crime. Studies by the Institute for Community Design Analysis found differences ranging from 6 to 24 percent between homeowners' association neighborhoods and otherwise comparable neighborhoods in St. Louis, in large measure because of the greater security in the former.[15] Homeowners' insurance companies benefit directly from appreciation of neighborhood property values brought about by an effective association, because the policy coverage also rises proportionally. Second, as the incidence of crime and blight decreases, property insurance claims stand to fall simultaneously.

Insurance brokers experienced in writing blanket policies responded positively to the above challenge grant approach when contacted by researchers for this study. Barbara Wick, commercial sales manager for Condominium Insurance Specialists of America, Inc., and president-elect of the Community Association Institute Research Foundation, viewed it as offering a potentially effective marketing tool for brokers. A Pennsylvania-based insurance broker, Jeff Brown of Valley Forge Insurance Management, indicated that the approach could yield average savings of 25 percent to homeonwers annually on premiums, with no decline in the quality of coverage. Preparations for a pilot project are now under way in the District of Columbia.[16]

II. REALTY INDUSTRY CHALLENGE GRANTS

As with insurance companies, realtors can also offer challenge grants on a profitable basis. At present, most real estate agents rely upon case-by-case acquisition of properties for exclusive listing. Obtaining exclusive listing rights for properties in an up-and-coming neighborhood represents a potentially attractive arrangement for realty firms.

A typical challenge grant from a realty company could offer $250–500 to a new neighborhood enterprise association, provided (*a*) that the association enlisted a threshold level of propertyowners in support of neighborhood improvement efforts, and (*b*) that the association agreed to offer the realty firm exclusive right of first refusal to handle sales of neighborhood property for a limited period.

From the standpoint of the realty firm, such an arrangement provides significant benefits. The company could avoid sizable transaction costs and uncertainties in finding new properties to list. If the neighborhood takes effective actions to improve living conditions, moreover, the benefits are capitalized into real estate values—yielding higher commissions for the realty firm. Winfield Sealander of Sealander Brokerage, a Washington-based realtor specializing in transitional neighborhoods, noted in an interview with project researchers that the prospect of such benefits would prompt his company to lower commissions by two or three percentage points.[17]

Residents of the neighborhood would also benefit from the realty challenge grants in several ways. In return for adopting self-assessing covenants and agreeing to a sole-source relationship with a realty firm, neighborhood residents could obtain start-up funding for their association and be able to bargain for reductions in the realtor's percentage rate for commissions. Effective neighborhood improvement efforts would also produce a more attractive living environment, and positively influence property values.

The challenge grant approach outlined above can be implemented through two means—as an initiative of private companies, or as an initiative of neighborhood associations themselves. By either means, the private sector challenge grants can be instrumental in alleviating fiscal strains among governments at all levels.

A business-initiated challenge grant program appears feasible with minimal delay; it awaits a firm willing to offer seed funding to neighborhoods forming covenant-backed self-help associations, in return for group purchase of insurance and/or realty services. The second alternative is for neighborhood groups to take the initiative in soliciting challenge grants. A neighborhood association—newly-formed or established—would announce its intention to enter into a sole-source group contract with an insurance and/or realty firm. Offering the prospect of group contracting gives neighborhood associations potentially strong leverage; in return for offering a sole source contract for a limited period, the neighborhood associations could shop around for the most attractive initial challenge grant, and the most favorable terms of the actual contract.

The amount of private sector challenge grants—and the attractiveness of the contract terms—depends to a large degree upon perceptions by insurance and realty firms of each association's ability to enhance property values. To attract a grant in distressed areas, for example, an association would probably have to demonstrate a capability to mobilize and maintain active support by its members for crime prevention and cleanup/fixup efforts. A powerful, covenant-backed self-assessing agreement with a high level of membership on the part of propertyowners on a block would provide strong evidence of a group's ability to increase property values in the area.

A private sector challenge grant program represents a clear plus for federal, state, and local governments. At no cost to taxpayers, it can create a framework capable of sustaining powerful neighborhood self-improvement initiatives.

3. General Guidelines for Challenge Grants

Several guidelines for successful implementation of both private and public sector challenge grants deserve brief mention. First, clear rules for eligibility must be defined; complicated or ambiguous criteria will deter neighborhoods from making the effort to qualify. Second, the disbursement of the challenge grants should be made as automatic and immediate as possible, once the qualifying criteria have been met; reducing the uncertainties and delays association with many traditional grant programs is essential if neighborhood enterprise associations are to be widely applied.

Finally, private and public sector institutions providing challenge grants should make every effort to coordinate or harmonize their respective grant disbursement criteria. By making the disbursement criteria consistent, the burdens of meeting and documenting multiple requirements can be greatly lessened for associations. Moreover, bundling together a number of challenge grants will be more likely to prompt the desired response from neighborhoods around the country.

C. CONCLUSIONS

A new generation of neighborhood associations—the enterprise association—can make substantial contributions to reduced fiscal strains and increased tax revenues. The enterprise association would resemble conventional propertyowners' associations in reliance upon deed-based covenants to ensure a high level of support from propertyowners on a block for services and facilities that benefited all. Unlike traditional propertyowners' associations, however, the enterprise association would safeguard the interests of disadvantaged residents who cooperated in improving the livability—and hence property values—of their neighborhood.

Public and private sector challenge grants can play a key role in inducing neighborhoods to establish enterprise associations. Governments at all levels can offer tax incentives, property transfers, service contracts, and grants to enterprise associations on a preferential basis, as a means of encouraging neighborhood self-sufficiency. Fiscal benefits for governments from such challenge grants would arise from diminished neighborhood needs for public services, from strengthened property tax bases, and (for federal and state governments) from reduced deductions by taxpayers for local taxes.

As a general rule, the amount of the public sector challenge grants should be a function of the savings generated for the level of government in question by neighborhood's increased self-sufficiency. The favorable fiscal consequences of neighborhood enterprise associations depend in large part upon the retention by the sponsoring government of some percentage of the savings generated by service divestiture. A second guiding principle in disbursing public sector challenge grants to neighborhood groups, at least in distressed areas, should be a requirement that the groups enable disadvantaged residents to benefit in some direct way as property values rise. This approach, if adhered to, can help motivate tenants to take part in neighborhood improvement initiatives—and potentially ease demands upon income maintenance programs in areas that succeed in "taking off."

Based upon preliminary soundings by project researchers, insurance brokers appear to be a promising near-term source of private source challenge grants for neighborhoods adopting self-assessing covenants and agreeing to purchase (at substantial savings) insurance policies on a group rather than individual basis. Realtors, in return for similar sole-source contracts, are another potential near-term source of mobilization grants for associations ready to undertake neighborhood improvement efforts.

The approaches described in this section are not a simple panacea for the fiscal problems of federal, state, or local governments. Capital-intensive public services have economies of scale that render provision difficult for all but the largest propertyowners' associations (or federations of smaller associations. In addition, the state of accounting practices in the public sector is generally deplorable—making it difficult for governments to set a fair value on their challenge grants to neighborhoods.

Nonetheless, substantial cost savings appear possible by transferring many service delivery responsibilities to the private sector through self-assessing neighborhood enterprise associations. The private sector has an opportunity to begin offering challenge grants without delay that can boost property values and hence strengthen tax bases. Conservatives and liberals alike appear in agreement on the desirability of responsive, decentralized institutions to meet community needs. In a climate of growing concern about the need for reducing public expenditures and generating new revenues, enterprise associations represent a practical step that can be taken in the near future toward fiscal responsibility.

V. FISCAL IMPACTS OF NEIGHBORHOOD SELF-HELP

The purpose of this chapter is to assess the extent to which increased neighborhood self-sufficiency could affect federal, state and local finances. The first section, Impacts on Spending, looks at how strengthened neighborhood organizations might reduce federal, state and local expenditures. The second section, Impact on Revenues, examines possible effects of neighborhood self-help on government receipts. Finally, the third section consolidates the information from the previous two sections to reach a very preliminary fiscal "bottom line". This bottom line serves as a means by which to evaluate the feasibility of possible private and public sector challenge grants for stimulating increased transfers of service responsibilities to neighborhood organizations.

A. Impacts on Spending

1. Federal Benefit From Strengthened Neighborhood Organizations

One of the ways in which neighborhood organizations might help the Federal government save money is by reducing the amount it spends on grants and programs for local areas. As discussed in Chapter III, neighborhood organizations have demonstrated capabilities to provide a range of housing, job training, and community services on a highly cost-effective basis. Accordingly, strategies that strengthen neighborhood self-help organizations—including homeowners' associations, Neighborhood Development Organizations, and hybrid "enterprise associations"—can reduce demands in the following program areas now financed by the Federal Government:

i. General Revenue Sharing;
ii. Training and Employment;
iii. Aid to Families With Dependent Children;
iv. Subsidized Housing; and
v. Social Services Block Grants.

Table V-1 depicts how federal expenditures for these services are expected to grow over the next five years (1984-1989), based upon historical trends in recent years.[1] These are estimates made by the Office of Management and Budget and may be conservative, given the past pattern of Congressional appropriations relative to Administration proposals. Even under conservative assumptions, the high cost of these services is clearly evident. In 1985, for example, the federal government will be spending more than $10 billion dollars for the subsidized housing program alone. In the aggregate, spending on all five programs in Fiscal 1985 exceeds $26 billion.

TABLE V-1.—PUBLIC EXPENDITURE SAVINGS TO THE FEDERAL GOVERNMENT FROM INCREASED NEIGHBORHOOD SELF-SUFFICIENCY

[In millions of dollars]

	1984	1985	1986	1987	1988	1989
Expenditures assuming no neighborhood association takeover:						
Subsidized housing	9,787.00	10,729.00	11,354.00	12,058.00	12,706.00	13,342.00
Aid to families with dependent children	6,629.00	6,828.00	6,963.00	7,071.00	7,123.00	7,272.00
General revenue sharing	4,574.00	4,575.00	4,575.00	4,576.00	4,576.00	4,577.00
Training and employment	2,974.00	3,056.00	3,146.00	3,262.00	3,374.00	3,478.00
Social service block grant	2,772.00	2,757.00	2,702.00	2,700.00	2,700.00	2,700.00
Totals	26,736.00	27,945.00	28,740.00	29,667.00	30,479.00	31,369.00
Savings due to a 1 percent neighborhood service takeover:						
Subsidized housing	97.87	107.29	113.54	120.58	127.06	133.42
Aid to families with dependent children	66.29	68.28	69.63	70.71	71.23	72.72
General revenue sharing	45.74	45.75	45.75	45.76	45.76	45.77
Training and employment	29.74	30.56	31.46	32.62	33.74	34.78
Social service block grant	27.72	27.57	27.02	27.00	27.00	27.00
Totals	267.36	279.45	287.40	296.67	304.79	313.69
Savings due to a 2 percent neighborhood service takeover:						
Subsidized housing	195.74	214.58	227.08	241.16	254.12	266.84
Aid to families with dependent children	132.58	136.56	139.26	141.42	142.46	145.44
General revenue sharing	91.48	91.50	91.50	91.52	91.52	91.54
Training and employment	59.48	61.12	62.92	65.24	67.48	69.56
Social service block grant	55.44	55.14	54.04	54.00	54.00	54.00
Totals	534.72	558.90	574.80	593.34	609.58	627.38
Savings due to a 5 percent neighborhood service takeover:						
Subsidized housing	499.35	536.45	567.70	602.90	635.30	667.10
Aid to families with dependent children	331.45	341.40	348.15	353.55	356.15	363.60
General revenue sharing	228.70	228.75	228.75	228.80	228.80	228.85
Training and employment	148.70	152.80	157.30	163.10	168.70	173.90
Social service block grant	277.20	138.60	137.85	135.10	135.00	135.00
Totals	1,336.80	1,397.25	1,437.00	1,483.35	1,523.95	1,568.45
Savings due to a 10 percent neighborhood service takeover:						
Subsidized housing	978.70	1,072.90	1,135.40	1,205.80	1,270.60	1,334.20
Aid to families with dependent children	662.90	682.80	696.30	707.10	712.30	727.20
General revenue sharing	457.40	457.50	457.50	457.60	457.60	457.60
Training and employment	297.40	305.60	314.60	326.20	337.40	347.80
Social service block grant	277.20	275.70	270.20	270.00	270.00	270.00
Totals	2,673.60	2,794.50	2,874.00	2,966.70	3,047.90	3,136.90
Savings due to a 15 percent neighborhood service takeover:						
Subsidized housing	1,468.05	1,609.35	1,703.10	1,808.70	1,905.90	2,001.30
Aid to families with dependent children	994.35	1,024.20	1044.45	1,060.65	1068.45	1090.80
General revenue sharing	686.10	686.25	686.25	686.40	686.40	686.55
Training and employment	446.10	458.40	471.90	489.30	506.10	521.70
Social service block grant	415.80	413.55	405.30	405.00	405.00	405.00
Totals	4,010.40	4,191.75	4,311.00	4,450.05	4,571.85	4,705.35

Neighborhood organizations are capable of eliminating at least some portion of this cost: homeowners' associations reduce consumption of local services funded by federal general revenue sharing, while Neighborhood Development Organizations have proven effective in provision of low-income housing, job counselling and referral, social service delivery. As can be seen in the bottom half of Table V-1, a reduction of only one percent in federal expenditures for these services via strengthened neighborhood organizations results in a savings of $267.4 million in FY 1985. A two percent savings would yield $534.7 million, a five percent savings would yield $1.34 billion, and a 10 percent savings would produce a $2.67 billion savings. With a 15 percent service takeover, the federal government would save $4.01 billion.[2]

2. State Benefits From Strengthened Neighborhood Organizations

In contrast to Federal Government disbursements, the bulk of state government spending that would be diminished by stronger neighborhood organizations exists in the form of transfers to municipalities. Because the state programs vary widely in size and scope, they have been aggregated for the purpose of analysis with local government spending (see section 3 below). Any success by neighborhood organizations in reducing expenditures for local governments thus could have secondary spending relief effects on the state governments.

3. Local Benefits From Strengthened Neighborhood Organizations

The local level is where spending reductions from strengthened neighborhood organizations have perhaps the greatest potential. Based upon the evidence reviewed in the study, spending on the following five major services now provided by local governments may be reduced by strengthened neighborhood organizations:

i. Police Protection;
ii. Sanitation other than Sewage;
iii. Parks and Recreation;
iv. Housing and Urban Renewal; and
v. Transit Systems.

The approach used to estimate such effect is identical with that used for the Federal Government. Table V-2 shows the costs of these services to the local government over a seven year period, 1982-1989.[3] As illustrated in the chart the costs of these services to the local government are very large. For example, the predicted total cost for fiscal year 1985 amounts to over $45 billion. Again, as with the federally funded programs, strengthened neighborhood organizations are not expected to eliminate these costs, but they could generate significant reductions in them.

Table V-2 provides a rough estimate of the potential effect that strengthened neighborhood organizations could have on local expenditures.[4] Specifically, it illustrates the savings that would accrue to the local government if strengthened neighborhood organizations took over up to 15 percent of the government services. These are not unreasonable expectations, given that a number of homeowners' associations have demonstrated abilities, as described in Chapter III, to arrange for local services on a virtually across-the-board basis. As can be seen in Table V-2, the savings generated under these scenarios are significant: $2.29 billion, $4.57 billion and $6.86 billion for service transfers of 1 percent, 2 percent, 5 percent, 10 percent, and 15 percent respectively (figures for Fiscal Year 1985). Because of the efficiencies of private vs. public sector service provision (see Chapter II), transfers of service responsibilities to neighborhood organizations are not only capable of easing fiscal burdens in the public sector, but of reducing the overall cost to the economy of delivering community services.

TABLE V–2.—PUBLIC EXPENDITURE SAVINGS TO LOCAL GOVERNMENTS FROM INCREASED NEIGHBORHOOD SELF-SUFFICIENCY

[Dollars in millions]

[Assumed rate of growth in local government spending: 1.12 percent]

	1982	1983	1984	1985	1986	1987	1988	1989
Inflation rate		3.10	4.80	5.10	4.90	4.70	4.50	4.30
Service expenditures assuming no neighborhood association takeover:								
Police protection	$14,064.40	$14,662.80	$15,538.72	$16,514.11	$17,517.32	$18,546.05	$19,597.68	$20,669.31
Sanitation	4,136.60	4,312.60	4,570.23	4,857.10	5,152.17	5,454.74	5,764.04	6,079.23
Parks/recreation	5,789.11	6,035.42	6,395.96	6,797.44	7,210.38	7,633.82	8,066.69	8,507.79
Housing/urban renwal	7,609.80	7,933.58	8,407.51	8,935.26	9,478.06	10,034.68	10,603.68	11,183.51
Transit services	7,394.33	7,708.94	8,169.45	8,682.26	9,209.69	9,750.55	10,303.44	10,866.85
Total	38,994.24	40,653.34	43,081.87	45,786.17	48,567.62	51,419.83	54,335.54	57,306.69
Savings due to a 1-percent neighborhood service takeover:								
Police protection	140.64	146.63	155.39	165.14	175.17	185.46	195.98	206.69
Sanitation	41.37	43.13	45.70	48.57	51.52	54.55	57.64	60.79
Parks/recreation	57.89	60.35	63.96	67.97	72.10	76.34	80.67	85.08
Housing/urban renwal	76.10	79.34	84.08	89.35	94.78	100.35	106.04	111.84
Transit services	73.94	77.09	81.69	86.82	92.10	97.51	103.03	108.67
Total	389.94	406.53	430.82	457.86	485.68	514.20	543.36	573.07
Savings due to a 2-percent neighborhood service takeover:								
Police protection	281.29	293.26	310.77	330.28	350.35	370.92	391.95	413.39
Sanitation	82.73	86.25	91.40	97.14	103.04	109.09	115.28	121.58
Parks/recreation	115.78	120.71	127.92	135.95	144.21	152.68	161.33	170.16
Housing/urban renwal	152.20	158.67	168.15	178.71	189.56	200.69	212.07	223.67
Transit services	147.89	154.18	163.39	173.65	184.19	195.01	206.07	217.34
Total	779.88	813.07	861.64	915.72	971.35	1,028.40	1,086.71	1,146.13
Savings due to a 5-percent neighborhood service takeover:								
Police protection	703.22	733.14	776.94	825.71	875.87	927.30	979.88	1,033.47
Sanitation	206.83	215.63	228.51	242.86	257.61	272.74	288.20	303.96
Parks/recreation	289.46	301.77	319.80	339.87	360.52	381.69	403.33	425.39
Housing/urban renwal	380.49	396.68	420.38	446.76	473.90	501.73	530.18	559.18

TABLE V-2.—PUBLIC EXPENDITURE SAVINGS TO LOCAL GOVERNMENTS FROM INCREASED NEIGHBORHOOD SELF-SUFFICIENCY—Continued

[Dollars in millions]

[Assumed rate of growth in local government spending: 1.12 percent]

	1982	1983	1984	1985	1986	1987	1988	1989
Transit services	369.72	385.45	408.47	434.11	460.48	487.53	515.17	543.34
Total	1,949.71	2,032.67	2,154.09	2,289.31	2,428.38	2,570.99	2,716.78	2,865.33
Savings due to a 10-percent neighborhood service takeover:								
Police protection	1,406.44	1,466.28	1,553.87	1,651.41	1,751.73	1,854.60	1,959.77	2,066.93
Sanitation	413.66	431.26	457.02	485.71	515.22	545.47	576.40	607.92
Parks/recreation	578.91	603.54	639.60	679.74	721.04	763.38	806.67	850.78
Housing/urban renwal	760.98	793.36	840.75	893.53	947.81	1,003.47	1,060.37	1,118.35
Transit services	739.43	770.89	816.95	868.23	920.97	975.05	1,030.34	1,086.69
Total	3,899.42	4,065.33	4,308.19	4,578.62	4,856.76	5,141.98	5,433.55	5,730.67
Savings due to a 15-percent neighborhood service takeover:								
Police protection	2,109.66	2,199.42	2,330.81	2,477.12	2,627.60	2,781.91	2,939.65	3,100.40
Sanitation	620.49	646.89	685.53	728.57	772.83	818.21	864.61	911.88
Parks/recreation	868.37	905.31	959.39	1,019.62	1,081.56	1,145.07	1,210.00	1,276.17
Housing/urban renwal	1,141.47	1,190.04	1,261.13	1,340.29	1,421.71	1,505.20	1,590.55	1,677.53
Transit services	1,109.15	1,156.34	1,225.42	1,302.34	1,381.45	1,462.58	1,545.52	1,630.03
Total	5,849.14	6,098.00	6,462.28	6,867.93	7,285.14	7,712.97	8,150.33	8,596.00

B. Impact on Revenues

Benefits to government from strengthened neighborhood self-help capabilities go beyond reducing expenditures at a federal, state and local level. The issue to be examined here is the potential impact of increased community self-sufficiency upon revenues collected by these governments.

1. Impact on Federal Tax Revenues

A notable effect of strengthened neighborhood organizations would be to increase Treasury receipts by diminishing the size of Federal tax deductions taken for local tax payments. Increased neighborhood self-sufficiency can reduce municipal spending—and hence the amount of local taxes consumed—by a significant ratio. Assuming that a substantial share of a city's services were privatized by strengthened neighborhood organizations, local expenditures could decline by a similar amount, which in turn could be reflected in a lessening of local tax burdens. At a Federal level, this decrease in local tax payment would represent a decrease in local tax deductions taken against Federal income taxes. The exact amount of revenue obtained by the Federal Government would depend on the extent of spending cutbacks at the local level as well as the marginal rate of taxation of the individuals living in the community.

Table V-3 illustrates the annual tax revenue loss to the Treasury resulting from deductibility of local taxes over a seven year period, 1982-1989.[5] These figures are quite substantial; for example, in 1985, they amount to foregone revenues of over $33.6 billion. Strengthened neighborhood organizations could considerably reduce the tax loss to the Federal government. It appears consistent with research findings that neighborhood organizations could reduce this amount by as much as 10 or 15 percent, through takeovers of service responsibility. An estimate of the federal revenue increase resulting from this reduction in local tax deductibility under each of the hypothesized conditions is provided in Table V-3.

Other revenue benefits, less readily quantifiable, would also accrue to the federal government in addition to those listed above. At present, most public services are provided by tax-exempt governmental organizations. To the extent that the neighborhood organizations make arrangements with for-profit enterprises to deliver basic services (refuse collection, snow-removal, daycare, etc.), the federal government stands to increase its income tax receipts.

TABLE V-3.—REVENUE INCREASES TO THE FEDERAL GOVERNMENT FROM REDUCED TAXPAYER DEDUCTIONS OF LOCAL TAX PAYMENTS

[Dollars in millions]

[Assumes percentage of Federal taxpayers itemizing deductions is: 31 percent]

[Assumes average tax rate for itemizing individuals is: 24 percent]

	1982	1983	1984	1985	1986	1987	1988	1989
Average percent real growth in local tax deductions	4.49	4.49	4.49	4.49	4.49	4.49	4.49	4.49
Expected CPI		3.1	4.8	5.1	4.9	4.7	4.5	4.3
Federal revenue lost under local tax deductions	$27,490.00	$29,614.75	$32,429.79	$35,614.07	$39,036.58	$42,706.43	$46,632.02	$50,821.01
Savings due to a 1-percent neighborhood service takeover	$20.55	$22.00	$24.10	$26.49	$29.00	$31.77	$34.69	$37.81
Savings due to a 2-percent neighborhood service takeover	$41.10	$44.00	$48.20	$53.98	$58.00	$63.54	$69.38	$75.62
Savings due to a 5-percent neighborhood service takeover	$102.26	$110.17	$120.64	$132.48	$145.22	$158.87	$173.47	$189.05
Savings due to a 10-percent neighborhood service takeover	$204.53	$220.33	$241.28	$264.97	$290.43	$317.43	$346.94	$378.11
Savings due to a 15-percent neighborhood service takeover	$306.79	$330.50	$361.92	$397.45	$435.65	$476.60	$520.41	$567.16

Sources/assumptions: See footnote 5.

2. Impact on State Revenues

The impact of strengthened neighborhood organizations on State revenues is very similar to their impact on Federal revenues—increased neighborhood self-sufficiency would reduce the over-all spending of the local government which, in turn, would reduce the amount of local tax deductions taken against State taxes.

Substantial difficulties arise, however, in attempting to compute the magnitude of the effect upon state government revenues. Most states allow for some deductions of local taxes. Unlike the Federal Government, however, the states have differing policies on granting this deductibility. The policy variations stem particularly from the methods used by state in collecting their taxes.

Three general categories of tax collection are presently in use by state governments:

i. Charging a percentage of individuals' federal tax payments. Because the Federal income tax allows for local tax deductions, a state deduction for such purposes as implicit under this approach.

ii. Charging a percentage of individuals' Federal gross income and then offering explicit opportunities for itemized deductions. Although states employing this system usually offer deductions for local tax payments, there is great variation in the size of the deduction and the specific type of local taxes that are deductible.

iii. Charging taxes based on formula independent of federal tax procedures. Many states have their own methods of determining state income tax liabilities, but few of these—six in all—allow for local tax deductions.

Given this variation in policy regarding deductibility of local taxes, it is difficult to compute the actual impact that strengthened neighborhood organizations might have on reducing local deductions taken against state income taxes. This should not obscure the fact, however, that neighborhood self-sufficiency would clearly have favorable effects upon tax revenues collected by most states.

3. Impact on Local Revenues

Strong neighborhood organizations can have a powerful, and positive, effect upon the property tax base of municipalities. As noted in Chapter III, homeowners' associations in particular have demonstrated their ability to greatly increase property values in disadvantaged as well as middle and upper income neighborhoods. Oscar Newman, in "Community of Interest," found differentials of 6 to 24 percent in property values between blocks with homeowners associations and "twin" blocks without them.[6] In a number of cities, property values in distressed neighborhoods have risen by 200 percent or more within 18 months of establishing a homeowners' association.[7]

The crime-prevention effects alone of cohesive neighborhood associations are enough to add hundreds of thousands of dollars to the value of property on an average inner-city block. As noted previously, crime watches and other block-level community crime prevention efforts consistently have proven able to reduce the incidence of crime by from 20 to 60 percent. Economists Charles M.

Gray and Mitchell R. Joelson, in "Neighborhood Crime and the Demand for Central City Housing," conducted in 1978 an extensive analysis of the effect of crime in the Minneapolis area. They concluded that both vandalism and residential burglary have strong effects on the value of owner-occupied homes: for every 10 percent the crime rate falls, the average value of an owner-occupied unit rises by $3,360.[8]

The effect of neighborhood organizations on local government revenues thus can be very significant. In 1982, local governments obtained 42.8 percent of their revenues from property taxes—excluding property taxes to school districts.[9] Although local governments' reliance on the property tax as a revenue source has declined in recent years, it remains and is likely to continue to be the largest local revenue source.

Table V-4 indicates the possible revenue increases that strengthened neighborhood organizations can bring to local governments.[10] This table is divided into three parts. The first part, "Increase in Property Value Due to Crime Reduction," provides an estimate of the increase in the value of owner occupied houses that would be obtained through various crime reduction scenarios brought about by strengthened neighborhood organizations. The second part of the Table, "Increase in Property Tax per Owner Occupied Household," predicts how much more the local governments could collect in property tax revenues per house because of reduced crime. (Three scenarios for the level of crime reduction are presented here). The third section, "Total US Increase in Property Taxes," shows the potential national increase in local property tax receipts, under various scenarios of neighborhood organization expansion as well as various assumptions regarding the success of crime prevention efforts. All of the above figures are extrapolated for 10 years (1979–1989).

TABLE V-4.—INCREASES IN PROPERTY TAX PAYMENTS RESULTING FROM NEIGHBORHOOD CRIME REDUCTION

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
CPI	11.3	13.5	10.4	6.1	3.1	4.8	5.1	4.9	4.7	4.5	4.3
A. Increase in property value due to crime reduction of:											
15 percent	$6,427.58	$7,295.30	$8,054.01	$8,545.30	$8,810.21	$9,233.10	$9,703.99	$10,179.48	$10,657.92	$11,137.52	$11,616.44
30 percent	12,855.15	14,590.60	16,108.02	17,090.61	17,620.41	18,466.19	19,407.97	20,358.96	21,315.83	22,275.05	23,232.87
45 percent	19,282.73	21,885.89	24,162.03	25,635.91	26,430.62	27,699.29	29,111.36	30,538.44	31,973.75	33,412.57	34,849.31
B. Increase in property tax per owner-occupied home due to crime reduction of:											
15 percent	83.56	94.84	104.70	111.09	114.53	120.03	126.15	132.33	138.55	144.79	151.01
30 percent	167.12	189.68	209.40	222.18	229.07	240.06	252.30	264.67	277.11	289.58	302.03
45 percent	250.68	284.52	314.11	333.27	343.60	360.09	378.46	397.00	415.66	434.36	453.04
C. Total U.S. increase in local property tax:											
Owner-occupied homes (millions)	51.41	52.70	54.01	55.36	56.75	58.17	59.62	61.11	62.64	64.20	65.81
1 percent of U.S. homes join homeowners' associations, and crime falls by:											
15 percent	42.96	49.98	56.55	61.50	64.99	69.82	75.21	80.87	86.79	92.96	99.38
30 percent	85.91	99.95	113.10	123.00	129.99	139.63	150.42	161.74	173.57	185.92	198.76
45 percent	128.87	149.93	169.66	184.51	194.98	209.45	225.63	242.61	260.36	278.88	298.14
2 percent of U.S. homes join homeowners' associations, and crime falls by:											
15 percent	85.91	99.95	113.10	123.00	129.99	139.63	150.42	161.74	173.57	185.92	198.76
30 percent	171.83	199.90	226.21	246.01	259.98	279.27	300.85	323.48	347.15	371.84	397.52
45 percent	257.74	299.85	339.31	369.01	389.96	418.90	451.27	485.22	520.72	557.76	596.28
5 percent of U.S. homes join homeowners' associations, and crime falls by:											
15 percent	214.79	249.88	282.76	307.51	324.97	349.08	376.06	404.35	433.93	464.80	496.90
30 percent	429.57	499.76	565.52	615.02	649.94	698.16	752.12	808.69	867.87	929.60	993.81
45 percent	644.36	749.63	848.29	922.53	974.91	1,047.25	1,128.17	1,213.04	1,301.80	1,394.39	1,490.71
10 percent of U.S. homes join homeowners' associations, and crime falls by:											
15 percent	429.57	499.76	565.52	615.02	649.94	698.16	752.12	808.69	867.87	929.60	993.81
30 percent	859.15	999.51	1,131.05	1,230.94	1,299.88	1,396.33	1,504.23	1,617.39	1,735.74	1,859.19	1,987.62
45 percent	1,288.72	1,499.27	1,696.57	1,845.06	1,949.82	2,094.49	2,256.35	2,426.08	2,603.61	2,788.79	2,981.42

TABLE V-4.—INCREASES IN PROPERTY TAX PAYMENTS RESULTING FROM NEIGHBORHOOD CRIME REDUCTION—Continued

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
15 percent of U.S. homes join homeowners' associations, and crime falls by:											
15 percent	644.36	749.63	848.29	922.53	974.91	1,047.25	1,128.17	1,213.4	1,301.80	1,394.39	1,490.71
30 percent	1,288.72	1,499.27	1,696.57	1,845.06	1,949.82	2,094.49	2,256.35	2,426.08	2,603.61	2,788.79	2,981.42
45 percent	1,933.08	2,248.90	2,544.86	2,767.60	2,924.73	3,141.74	3,384.52	3,639.12	3,905.41	4,183.18	4,472.14

Note.—Increase in property value due to 1-percent decrease in crime reduction (1976): $336—inflated to 1979 via CPI. Average percentage of property value paid each year in taxes: 1.3 percent. Increase in number of owner-occupied households every year: 2.5 percent.

Three points are instructive in analyzing Table V-4. First, the lower estimates of association membership (1, 2, and 5 percent of total U.S. owner occupied households) are most likely under a weak incentives system, such as that provided by private sector challenge grants. The higher range estimates (5, 10, and 15 percent of total U.S. owner-occupied households) are most likely to occur under a strong federal incentives program, such as offering deductibility for self-assessed fees.

Second, the estimated impacts of neighborhood organizations in increasing local property tax bases may be substantially understated. The projections in Table V-4 are based only upon property value appreciation attributable to reduced crime. Homeowners associations have demonstrated a clear ability, in addition, to increase the value and marketability of properties by making neighborhoods more resistant to physical neglect and decay.

Third, the increase in local government tax receipts need not increase fiscal strains for the Federal Treasury, provided either that (*a*) municipalities make compensating cuts in other local taxes, or (*b*) the Federal government reduces its block grants or other transfer payments to municipalities accordingly.

C. The Fiscal "Bottom Line"

This final section of the report is dedicated to finding a "bottom line" regarding the total costs and benefits of strengthened neighborhood organizations to Federal, State and local governments. The analysis first consolidates the spending and revenue projections provided in the two preceding sections of the chapter, under the assumption that private sector challenge grants (adding no new fiscal strain) will be the principal impetus for strengthening neighborhood organizations. The analysis then examines the potential fiscal effects upon the Federal government of offering a powerful public sector challenge grant—giving homeowners' association fees a federal tax deductible status comparable to that now provided for local taxes.

1. Net Fiscal Impacts Assuming Private Sector Challenge Grants

I. IMPACTS ON FEDERAL GOVERNMENT

Private sector organizations—most notably, homeowners' insurance firms and realtors—have reason to offer incentives for propertyowners to organize self-assessing associations. Not only do homeowners' associations represent a mechanism for purchasing insurance and realty services on a group basis, but they can increase neighborhood property values substantially. Rising property values, in turn, create needs for greater insurance policy coverage, as well as generate large brokerage commissions.

Philanthropic organizations also can help catalyze the formation of self-assessing propertyowners associations in distressed areas, to assist Neighborhood Development Organizations that own revenue-generating properties. Under either approach, the instrument for stimulating community enterprise would most likely take the form of private challenge grants.

Table V–5 examines the potential federal fiscal impacts of a purely private-sector challenge grants program.[11] By avoiding any outlay of public sector resources, the approach has exceptionally positive fiscal consequences. Assuming that private sector challenge grants result in a one percent savings to the targeted federal programs through stimulating greater neighborhood self-sufficiency, this approach would generate fiscal dividends of $279.5 million annually (FY1985). A two percent savings generated by strengthening homeowners' associations, Neighborhood Development Organizations, and/or enterprise associations would yield $558.9 million in fiscal benefits. A five percent savings would amount to $1.397 billion. Concurrently, the private neighborhood self-help incentives would benefit the federal government by easing demands for local spending. As municipal budgets decreased, the federal Treasury would stand to gain $26.5 million from a one percent decline in local tax deductions, $52.9 million from a two percent reduction, and $132.5 million from a five percent reduction.

TABLE V–5.—FISCAL IMPACTS OF STRENGTHENING NEIGHBORHOOD SELF-SUFFICIENCY THROUGH PRIVATE SECTOR INCENTIVES

[In millions of dollars]

	1985	1986	1987	1988	1989
A. Reductions in Federal expenditures for housing, AFDC, revenue sharing training/employment and social service block grants:					
Program spending under present policies	27,945.00	28,740.00	29,667.00	30,479.00	31,369.00
Federal savings from private neighborhood self-help incentives:					
1 percent savings	279.45	287.40	296.67	304.79	313.69
2 percent savings	558.90	574.80	593.34	609.58	627.38
5 percent savings	1,397.25	1,437.00	1,483.35	1,523.95	1,568.45
B. Increases in Federal revenue resulting from reduced deductions of local taxes:					
Local tax deductions	35,614.07	39,036.58	42,706.43	46,632.02	50,821.01
Reduced deductions from private neigborhood self-help incentives:					
1 percent savings	26.50	29.04	31.77	34.69	37.81
2 percent savings	52.99	58.09	63.55	69.39	75.62
5 percent savings	132.48	145.22	158.87	173.47	189.05
C. Net fiscal impact:					
Conservative scenario (1 percent Federal savings and 1 percent local tax savings)	305.95	316.44	328.44	339.48	351.50
Moderate scenario (2 percent Federal savings and 2 percent local tax savings)	611.89	632.89	656.89	678.97	703.00
Optimistic scenario (5 percent Federal savings and 5 percent local tax savings)	1,529.73	1,582.22	1,642.22	1,697.42	1,757.50

The net fiscal impact on the federal government would be significant. As indicated by Table V–5, a conservative scenario (assuming a one percent reduction in federal program spending and a one percent lessening of local spending) would generate $305.9 million annually. A moderate scenario (assuming two percent federal program spending reduction and a two percent local spending decline) would generate $611.9 million. Under more favorable assumptions (five percent federal program and five percent local spending reductions respectively), the fiscal gain to the federal Treasury would amount to $1.53 billion annually.

II. IMPACTS ON LOCAL GOVERNMENT

Because private sector challenge grants would offer no specific incentives for associations to assume municipal service responsibilities, they would have relatively modest effects on local revenues and local spending. Table V–2 indicates that a 1 percent reduction in local expenditures would generate $457.8 million in savings, a 2 percent decline would generate $915.4 million, and a 5 percent decline would generate $2.29 billion in savings. Concurrently, as shown in Table V–4, neighborhood association effects upon property values would raise $75.2 million in property taxes under a conservative scenario (assuming an additional one percent of homeowners participate nationally in homeowners' associations, and crime rates decline an average of 15 percent), $300.8 million in property taxes under a middle of the road scenario (two percent of homeowners and 30 percent average crime reduction), and $1.13 billion under an optimistic scenario (5 percent of homeowners and 45 percent average crime reduction). Thus, the net fiscal impact to local governments from private incentives for neighborhood self-sufficiency would be likely to range from $533 million under a conservative scenario to $3.42 billion under a favorable scenario.

The principal disadvantage of an exclusively private sector strategy is the likelihood that private incentives would be far less powerful than government incentives for creation of self-assessing associations. Private challenge grants, in particular, would be unlikely to induce associations to assume substantial public service provision roles. Consequently, in the interest of fiscal relief, public sector bodies may be well advised to offer highly leveraged incentives to supplement those offered by the private sector.

2. Net Fiscal Impacts Assuming Public Sector Challenge Grants

I. IMPACTS ON FEDERAL GOVERNMENT

As discussed in Chapter IV, the Federal Government has an ability to offer powerful tax incentives for the expansion of neighborhood self-help capabilities. Perhaps the most effective such incentive would be a "challenge grant" extending tax deductibility to the portion of homeowners' association fees that covered the cost of municipal-style services.

Table V–6 projects the additional tax losses to the Treasury that would be incurred by extending tax deductibility to homeowners' association fees on this basis. The costs are projected over the next five years and reflect the following assumptions:

TABLE V–6.—REVENUE LOSSES TO THE FEDERAL GOVERNMENT FROM ALLOWING DEDUCTIONS FOR HOMEOWNERS' ASSOCIATION FEES

[Dollar amounts in millions]

	1984	1985	1986	1987	1988	1989
Projected CPI		5.1	4.9	4.7	4.5	4.3
Revenue loss:						
A. Assuming only "natural" growth or 1,250 associations/year:						
Number of associations	25,000	26,250	27,500	28,750	30,000	31,250
Incremental revenue loss	N/A	N/A	N/A	N/A	N/A	N/A
Total revenue loss	$9.30	$10.26	$10.73	$11.20	$11.66	$12.12
B. Assuming an added 100-percent increase in associations (1-time increase):						
Number of associations	25,000	51,250	52,500	53,750	55,000	56,250
Incremental revenue loss	$.00	$10.74	$.45	$.45	$.45	$.44
Total revenue loss	$9.30	$20.04	$20.49	$20.93	$21.38	$21.82
C. Assuming an added 200-percent increase in associations (1-time increase):						
Number of associations	25,000	76,250	77,500	78,750	80,000	81,250
Incremental revenue loss	$.00	$20.51	$.43	$.43	$.43	$.43
Total revenue loss	$9.30	$29.81	$30.24	$30.67	$31.10	$31.52
D. Assuming an added 500-percent increase in associations (1-time increase):						
Number of associations	25,000	151,250	152,500	153,750	155,000	156,250
Incremental revenue loss	$.00	$49.83	$.38	$.37	$.37	$.37
Total revenue loss	$9.30	$59.13	$59.51	$59.88	$60.25	$60.62

Note—Average deductible association fee: $100.00.
Average number of taxpayers per association: 50.
Average tax rate for itemizing individuals: 24 percent.
Average percentage of taxpayers itemizing: 31 percent.

i. The average deductible portion of an association member's annual fee would be equal to $100.

ii. The average number of taxpayers per association is 50.

iii. The number of associations in 1984 is estimated at 25,000, with a "natural" rate of increase of 1,250/year.

The most immediate fiscal impact of such a measure would be a $37.2 million annual loss of revenue, as existing homeowners' associations took advantage of deductibility. Subsequently, additional revenues would be foregone as taxpayers responded to incentives for forming propertyowners' associations that assumed public service delivery responsibilities.

Table V–6 assumes that deductibility of association fees would generate at least a one-time doubling in homeowners' associations and/or enterprise associations, on top of a 1250/year "natural" increase in the number of homeowners' associations, at an annual added revenue loss of about $10.7 million. The corresponding annual values for a trebling and quintupling in the numbers of homeowners' associations are $20.5 and $49.8 million respectively. [Note: for the sake of simplifying the projection, the entire increase in numbers of associations is projected to occur in one year—in practice, the rise in numbers could take considerably longer]. These assumptions of growth in homeowners' association numbers may appear to be high, but they should be viewed in perspective of the explosive growth over the past 20 years of homeowners' associations in the absence of any public sector encouragement. As noted in Chapter III, the number of covenant-backed, self-assessing homeowners' associations has risen in this period from fewer than 600 to more than 25,000.

Under a scenario of continuing rapid growth, revenue losses from fee deductibility are manageable because only 31 percent of all federal income taxpayers itemize their deductions, and because the federal government "loses" only 24 percent of each dollar deducted—the average federal income tax rate of taxpayers.[12] In practice, the revenue loss resulting from deductibility of association fees may be further reduced. Chapter II and III indicated that when private sector organizations are responsible for service delivery, they are more oriented than is the public sector to reducing "deadweight" or inefficiencies. Such inefficiencies are estimated variously to average between 25 and 60 percent of the cost of governmentally-provided local services. The aggregate cost of local service delivery should diminish as homeowners' associations take a larger role. Hence, overall federal tax deductions for local services might well be lower under a policy of extending deductibility to association fees than they are under the present system.

Table V-7 sums up the estimated fiscal consequences to the federal government of offering tax deductibility to association fees, by factoring in (*a*) reduced demands upon federal spending arising from neighborhood selfsufficiency and (*b*) revenue gains resulting from reduced local tax deductions, as demands for municipal spending subside.[13] The "bottom line" impact for a conservative scenario is $285.9 million annually, assuming a one percent decline in spending for the targeted federal programs, a one percent reduction in local tax deductions, and a one-time doubling in the number of associations. For a moderate scenario (assuming 5 percent declines in federal program spending and in local tax deductions, and a trebling in associations), the fiscal impact would be $1.49 billion. For a more optimistic scenario, assuming 10 percent federal and local declines, and a five-fold increase in associations, the fiscal impacts would be almost $3.0 billion.

TABLE V-7.—NET FEDERAL FISCAL IMPACTS OF STRENGTHENING NEIGHBORHOOD SELF-SUFFICIENCY THROUGH PUBLIC SECTOR INCENTIVES (DEDUCTIBILITY OF FEES)

[In millions of dollars]

	1965	1986	1987	1988	1989
A. Reductions in Federal expenditures for housing, AFDC, revenue sharing training/employment and social service block grants:					
Program spending under present policies	27,945.00	28,740.00	29,667.00	30,479.00	31,369.00
Federal Savings From Governmental Neighborhood Self-Help Incentives:					
1 percent savings	279.45	287.40	296.67	304.79	313.69
5 percent savings	1,397.25	1,437.00	1,483.35	1,523.95	1,568.45
10 percent savings	2,794.50	2,874.00	2,966.70	3,047.90	3,136.90
B. Increases in Federal revenue resulting from reduced deductions of local taxes:					
Local tax deductions under present policies	35,614.00	39,036.00	42,706.00	46,632.00	50,821.00
Revenue gains from reduced local tax deductions (induced by governmental incentives for neighborhood self-sufficiency):					
1 percent local savings	26.50	29.04	31.77	34.69	37.81
5 percent local savings	132.48	145.21	158.87	173.47	189.05

TABLE V–7.—NET FEDERAL FISCAL IMPACTS OF STRENGTHENING NEIGHBORHOOD SELF-SUFFICIENCY THROUGH PUBLIC SECTOR INCENTIVES (DEDUCTIBILITY OF FEES)—Continued

[In millions of dollars]

	1985	1986	1987	1988	1989
10 percent local savings	264.97	290.43	317.73	346.94	378.11
C. Federal tax revenue losses resulting from partial deductibility of homeowners association fees:					
Deductions by members of existing associations	10.26	10.73	11.20	11.66	12.12
Total deductions, assuming an additional:					
1-fold association growth	20.04	20.49	20.93	21.38	21.82
2-fold association growth	29.81	30.24	30.67	31.10	31.52
5-fold association growth	59.13	59.51	59.88	60.25	60.62
D. Net fiscal impact					
Conservative scenario:					
1 percent federal program savings, 1 percent local savings, and 1-fold association growth	285.91	295.95	307.51	318.10	329.68
Moderate scenario:					
5 percent federal program savings, 5 percent local savings, and 2-fold association growth	1,499.92	1,551.97	1,611.55	1,666.32	1,725.98
Optimistic scenario:					
10 percent federal program savings, 10 percent local savings, and 5-fold association growth	3,000.34	3,104.92	3,224.55	3,334.59	3,454.39

II. IMPACTS ON LOCAL GOVERNMENT

From the standpoint of local budgets, federal incentives would also yield substantial fiscal benefits. Assuming pessimistically that homeowners' associations and/or enterprise associations grew to encompass an additional one percent of all owner-occupied homes, and that crime rates in these neighborhoods fell by 15 percent, rising property values would increase property tax payments by $75.2 million (Table V–4, Fiscal Year 1985). If the new associations simultaneously reduced demands for local services by one percent, or $457.9 million (Table V–2, FY 1985), the net fiscal gain to local governments would be $533.1 million.

More favorable scenarios yield more striking benefits. Assuming that self-assessing associations grew to include an additional 5 percent of all American homes, and that crime rates declined on average by 30 percent, property tax receipts would rise by $752.1 million annually (FY 1985). A concurrent 5 percent takeover of local service responsibilities—reducing local government expenditures by 5 percent—would generate savings of $1.95 billion (FY 1985). The net gain for local governments under these circumstances would be $2.70 billion.

Finally, under optimistic premises (10 percent homeowners' associations nationwide, 45 percent average crime rate reductions, and 10 percent takeover of local services), revenues would rise by $2.26 billion annually and service costs would decline by $3.90 billion, leaving a net fiscal gain for local governments of $6.16 billion annually.

The fiscal impact assessments presented here indicate that substantial fiscal benefits—ranging from $819 million to $9.16 billion—can accrue to the public sector through a policy of strengthening community self-sufficiency.

Although the projections presented here are highly tentative, they suggest that much-needed fiscal relief for governments can be achieved, without tax increases or cuts in needed services. Private sector challenge grants appear to be a means of immediately initiating neighborhood self-sufficiency strategies. The prospective fiscal benefits from public sector challenge grants, however, are sufficiently large to warrant implementation on at least a demonstration basis without delay.

ANNEX A. TABLES

TABLE 1.—FEDERAL TAXES, SPENDING AND DEFICITS

	Federal taxes [1]	Percent of GNP	Federal spending [1]	Percent of GNP	Federal deficits [1]	Percent of GNP
Fiscal year:						
1921	$5.6	n.a.	$5.1	n.a.	+0.5	n.a.
1922	4.0	n.a.	3.3	n.a.	+.7	n.a.
1923	3.9	n.a.	3.1	n.a.	+.7	n.a.
1924	3.9	n.a.	2.9	n.a.	+1.0	n.a.
1925	3.6	n.a.	2.9	n.a.	+.7	n.a.
1926	3.8	n.a.	2.9	n.a.	+.9	n.a.
1927	4.0	n.a.	2.9	n.a.	+1.2	n.a.
1928	3.9	n.a.	3.0	n.a.	+.9	n.a.
1929	3.9	3.8	3.1	3.0	+.7	.7
1930	4.1	4.2	3.3	3.4	+.7	.7
1931	3.1	3.7	3.6	4.3	−6.5	7.8
1932	1.9	2.8	4.7	7.0	−2.7	4.0
1933	2.0	3.5	4.6	8.1	−2.6	4.6
1934	3.0	5.0	6.6	10.9	−3.6	5.9
1935	3.7	5.4	6.5	9.4	−2.8	4.1
1936	4.0	5.2	8.4	10.8	−4.4	5.7
1937	5.0	5.8	7.7	10.8	−2.8	3.2
1938	5.6	6.4	6.7	7.6	−1.2	1.2
1939	5.0	5.7	8.8	10.0	−3.9	4.4
1940	6.4	6.7	9.5	10.0	−3.1	3.3
1941	8.6	7.9	13.6	12.5	−5.0	4.6
1942	14.4	10.4	35.1	25.3	−20.8	15.0
1943	23.7	13.4	78.5	44.4	−54.9	31.1
1944	44.3	21.9	91.3	45.2	−47.0	23.3
1945	45.2	20.8	92.7	42.7	−47.5	21.9
1946	39.3	19.4	55.2	27.3	−15.9	7.9
1947	38.4	17.4	34.5	15.6	+3.9	1.8
1948	41.8	17.0	29.8	12.1	+12.0	4.9
1950	39.5	14.9	4.26	16.1	−3.1	1.2
1951	51.6	16.5	45.6	14.6	+6.1	2.0
1952	66.2	19.6	67.7	20.0	−1.5	.4
1953	69.6	19.3	76.1	21.1	−6.5	1.8
1954	69.7	19.1	70.9	19.5	−1.2	.3
1955	65.5	17.2	68.5	18.0	−3.0	.8
1956	74.5	18.1	70.5	17.1	+4.1	.9
1957	80.0	18.4	76.7	17.7	+3.2	.7
1958	79.6	18.0	82.6	18.6	−2.9	.7
1959	79.2	16.7	92.1	19.4	−12.9	2.7
1960	92.5	18.6	92.2	18.5	+0.3	.1
1961	94.4	18.5	97.8	19.2	−3.4	.7
1962	99.7	18.2	106.8	19.5	−7.1	1.3
1963	106.6	18.4	111.3	19.3	−4.8	.8
1964	112.7	18.2	118.6	19.2	−5.9	1.0
1965	116.8	17.7	118.4	18.0	−1.6	.2
1966	130.9	18.1	134.7	18.6	−3.8	.5
1967	148.9	19.2	157.6	20.3	−8.7	1.1
1968	153.0	18.4	178.1	21.4	−25.2	3.07
1969	186.9	20.5	183.6	20.2	+3.2	.4
1970	192.8	19.9	195.7	20.2	−2.8	.3
1971	187.1	18.1	210.2	20.4	−23.0	2.2

TABLE 1.—FEDERAL TAXES, SPENDING AND DEFICITS—Continued

	Federal taxes [1]	Percent of GNP	Federal spending [1]	Percent of GNP	Federal deficits [1]	Percent of GNP
Fiscal year:						
1972	207.3	18.4	230.7	20.4	−23.4	2.1
1973	230.8	18.4	245.7	19.6	−14.8	1.2
1974	263.2	19.1	267.9	19.4	−4.7	6.4
1975	279.1	18.9	324.3	21.9	−45.2	3.1
1976	298.1	18.2	364.5	22.2	−66.4	4.0
TQ	81.2	18.9	94.2	21.9	−13.0	3.0
1977	355.6	19.1	400.5	21.5	−44.9	2.4
1978	399.6	19.1	448.4	21.4	−48.8	2.3
1979	463.3	19.7	491.0	20.8	−27.7	1.2
1980	517.1	20.1	576.7	22.4	−59.6	2.3
1981	599.3	20.3	657.2	22.8	−57.9	2.0
1982	617.8	20.2	728.4	23.8	−110.6	3.6
1983	600.6	18.6	796.0	24.7	−195.4	6.1
1984 [2]	670.1	18.8	853.8	24.0	−183.7	5.2
1985 [2]	745.1	19.2	925.5	23.8	180.4	4.6
1986 [2]	814.9	19.3	992.1	23.4	−177.1	4.2
1987 [2]	887.8	19.3	1,068.3	23.3	−180.5	3.9
1988 [2]	978.3	19.7	1,130.3	22.8	−152.8	3.1
1989 [2]	1,060.3	19.8	1,183.7	22.1	−123.4	2.3

[1] Figures in billions.
[2] Estimates.

n.a.—Not available.

Source: Office of Management and Budget; National Income and Product Accounts of the United States, 1929–74; Statistical Table.

TABLE 2.—FEDERAL GRANTS-IN-AID TO STATE AND LOCAL GOVERNMENTS, 1940–85

	Total Federal grants-in-aid to State and local governments [1]	Percent of Federal budget
Year:		
1940	$0.9	9.2
1941	.8	6.2
1942	.9	2.5
1943	.9	1.2
1944	.9	1.0
1945	.9	0.9
1946	.8	1.5
1947	1.6	4.6
1948	1.6	5.4
1949	1.9	4.8
1950	2.3	5.3
1951	2.3	5.0
1952	2.4	3.6
1953	2.8	3.7
1954	3.1	4.3
1955	3.2	4.7
1956	3.7	5.3
1957	4.0	5.3
1958	4.9	6.0
1959	6.5	7.0
1960	7.0	7.6
1961	7.1	7.3
1962	7.9	7.4
1963	8.6	7.8
1964	10.1	8.6
1965	10.9	9.2

TABLE 2.—FEDERAL GRANTS-IN-AID TO STATE AND LOCAL GOVERNMENTS, 1940–85—Continued

	Total Federal grants-in-aid to State and local governments [1]	Percent of Federal budget
Year:		
1966	13.0	9.6
1967	15.2	9.7
1968	18.6	10.4
1969	20.3	11.0
1970	24.0	12.3
1971	28.1	13.4
1972	34.4	14.9
1973	41.8	17.0
1974	43.4	16.2
1975	49.8	15.4
1976	59.1	16.2
TQ	15.9	16.2
1977	68.4	17.1
1978	77.9	17.4
1979	82.9	16.9
1980	91.5	15.9
1981	94.8	14.4
1982	88.2	12.1
1983	93.5	11.6
1984 [2]	95.9	11.3
1985 [2]	99.2	10.8

[1] Figures in billions.

[2] Estimates.

Source: Office of Management and Budget.

TABLE 2a.—BLOCK GRANT SUMMARY

[$ in millions]

Block grant	Fiscal year 1982 appropriations	Percentage change from fiscal year 1981 appropriations	Date available for State assumption	Number of consolidated programs [1]	Number of States accepting block grant (as of April 1, 1982)	Matching and maintenance of effort requirements	Transfer provisions
Alcohol, drug abuse, and mental health.	$428.1	−20.8	October 1981	10 categoricals	49	Federal funds will be used to supplement non-Federal.	7 percent can be transferred for specified health purposes.
Community services	$336.5	−35.9	October 1981	7 categoricals	38	None	5 percent to Energy, Head Start, or Older Americans Act.
State community development.	States administered approximately 900 of total block of 3,456.0.		February 1982	1 discretionary	37	10 percent State match if State elects to distribute funds.	None.
Maternal and child health	$347.5	−23.5	October 1981	9 categoricals	48	$3 State for each $4 Federal.	None.
Elementary and secondary education.	$470.7 [2] [3]	[1] −10.5	July 1982	37 categoricals	Automatic transfer	Expenditures to be at least 90 percent of level of 2d prior fiscal year, Federal funds must supplement.	None.
Low-income home energy assistance.	$1,869 [2]	[2] +6.6	October 1981	1 categorical	Automatic transfer	None	10 percent to social services community services and health.
Primary care	$246.3 [4]	−23.9	October 1982	2 categoricals	Not yet available	Fiscal year 1983: 20 percent State match fiscal year 1984: 33⅓ match.	None.
Preventive health services	$81.6	−12.4	October 1981	1 block and 6 categoricals	48	Federal funds must supplement.	7 percent to health.
Social services	$2,400.0	−19.8	October 1981	1 block and 1 categorical	Automatic transfer	None	10 percent to health or energy block.

[1] The reported number of programs consolidated into the block grant differs with program definition. This listing is derived from Office of Management and Budget, "Catalog of Federal Grant Assistance."

[2] Includes consolidation under Chapter 2 of the Education Consolidation and Improvement Act of 1981 (a), (b), (c), (d).

[3] This program is advanced-funded. Therefore, Federal budget reductions do not affect State spending until next fiscal year.

[4] Block grant not available to States until fiscal year 1983. Appropriation total is for programs to be consolidated.

Source: George E. Peterson, "The State and Local Sector," in Palmer and Sawhil, eds., "The Reagan Experiment." Table 6–2

TABLE 3.—COMPOSITION OF FEDERAL TAXES, FISCAL YEAR 1985 [1]

Tax	Receipts [2]	Percent of total Federal receipts
Individual income taxes	$317.9	43.9
Corporate income taxes	60.5	8.4
Social Security taxes (OASDHI)	237.0	32.7
Other social insurance taxes	38.5	5.3
Excise taxes	40.9	5.6
Estate and gift taxes	5.6	0.8
Customs duties	9.4	1.3
Miscellaneous receipts	14.4	2.0
Total Federal receipts	724.3	

[1] All figures are estimates.
[2] Figures in billions.

Source: Office of Management and Budget.

TABLE 4—COMPOSITION OF FEDERAL SPENDING, FISCAL YEAR 1985 [1]

Spending category	Total spending [2]	Percentage of total Federal spending
National defense	285.3	30.3
Social Security and Medicare	259.3	27.5
Major welfare programs [3]	69.9	7.4
Other major entitlement programs [4]	91.3	9.7
Grants to State and local governments	50.8 (99.2)[5]	
Net interest	114.2	12.1
Other spending	72.3	7.7
Total Federal spending	943.1	100 percent
Minus: Undistributed offsetting receipts	24.6	
Net Federal spending	918.5	

[1] All figures are proposed estimates subject to change.
[2] Figures in billions of dollars
[3] Programs included are Medicaid, housing assistance programs, SSI, AFDC, and other income security programs.
[4] Programs included are Unemployment Compensation, Federal Employee Retirement and Disability Programs, Railroad Retirement, Disabled Coal Miners, Veterans Benefits, Agricultural Price Supports, and Farm Income Stabilization Programs.
[5] Total grants to State and local governments equals $99.2 billion, including $48.4 billion for payments to individuals and $50.8 billion to the governments themselves; the amounts for payments to individuals, however, are included in the other spending categories in the table.
[6] Figure in parenthesis is percent for total grants to State and local governments, see footnote 5.

Source: Budget of the United States Government, Fiscal Year 1985.

TABLE 5.—MAJOR FEDERAL GRANT-IN-AID PROGRAMS FOR STATE AND LOCAL GOVERNMENTS, FISCAL YEAR 1985 [1]

Program	Outlay [2]	Percent of total State and local grants
Grants for payments to individuals:		
Medicaid	$23.1	23.3
AFDC	6.9	7.0
Housing assistance	6.8	6.9
Other income security	8.2	8.3
Other grants:		
Highway construction	12.5	12.6
Mass transit	3.6	3.6
Revenue sharing and general purpose fiscal assistance	6.8	6.9
CDBG and UDAG	4.0	4.0
Education	6.8	6.9
Employment [3]	5.7	5.7
Social services	5.3	5.3

TABLE 5.—MAJOR FEDERAL GRANT-IN-AID PROGRAMS FOR STATE AND LOCAL GOVERNMENTS, FISCAL YEAR 1985 [1]—Continued

Program	Outlay [2]	Percent of total State and local grants
Sewage construction grants	2.7	2.7
Health grants	1.4	1.4
Agriculture	1.1	1.1

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[1] All figures are proposed estimates subject to change.

[2] Figures in billions.

[3] Includes Unemployment Trust Fund.

Source: Office of Management and Budget.

TABLE 6.—BUDGET BALANCES BY STATE, 1982–84

State	Fiscal year 1982 balance [1]	Percent of fiscal year 1982 expenditures	Fiscal year 1983 balance [1] [2]	Percent of fiscal year 1983 [2] expenditures	Fiscal year 1984 balance [1] [2]	Percent of fiscal year 1984 [2] expenditures
Alabama	$24	1.35	0	0.00	0	0.00
Alaska	266	6.24	$54	1.43	$90	3.26
Arizona	9	.56	20	1.20	17	.97
Arkansas	0	.00	0	.00	0	.00
California	100	.46	−885	−4.04	190	.86
Colorado	15	1.05	63	4.02	105	6.18
Connecticut	−40	−1.35	−56	−1.72	0	.00
Delaware	51	7.91	50	7.35	54	7.56
Florida	254	5.38	11	.21	67	1.19
Georgia	0	.00	0	.00	0	.00
Hawaii	210	17.07	97	6.96	83	5.74
Idaho	0	.00	0	.00	1	.22
Illinois	187	2.42	150	1.91	150	1.88
Indiana	0	.00	49	2.43	39	1.47
Iowa	22	1.25	48	2.54	51	2.52
Kansas	92	6.90	45	3.18	77	5.06
Kentucky	42	2.02	15	.66	3	.12
Louisiana	298	6.94	4	.10	4	.11
Maine	19	2.91	13	1.84	15	2.00
Maryland	156	5.32	37	1.15	6	.18
Massachusetts	4	.09	45	.99	31	.62
Michigan	6	.14	0	.00	0	.00
Minnesota	−598	−13.78	9	.25	−150	−3.31
Mississippi	39	3.16	31	2.52	0	.00
Missouri	63	3.05	53	2.38	55	2.32
Montana	34	9.77	22	6.43	13	3.68
Nebraska	−16	−2.15	−9	−1.15	22	3.03
Nevada	46	12.72	44	10.02	43	11.24
New Hampshire	−33	−10.86	−37	−11.46	−11	−3.22
New Jersey	134	2.34	110	1.75	55	.81
New Mexico	209	18.51	43	3.29	58	4.65
New York	62	.41	0	.00	51	.29
North Carolina	109	3.31	1	.03	0	.00
North Dakota	109	26.20	16	3.75	30	6.11
Ohio	50	.83	13	.18	80	1.00
Oklahoma	377	23.33	74	3.85	0	.00
Oregon	−139	−9.68	2	.14	−33	−2.04
Pennsylvania	8	.10	−235	−3.07	5	.07
Rhode Island	3	.37	2	.23	0	.00
South Carolina	0	.00	0	.00	0	.00
South Dakota	20	7.43	7	2.49	5	1.75
Tennessee	34	1.94	11	.60	11	.56
Texas	1,496	28.59	630	6.44	22	.22

TABLE 6.—BUDGET BALANCES BY STATE, 1982–84—Continued

State	Fiscal year 1982 balance [1]	Percent of fiscal year 1982 expenditures	Fiscal year 1983 balance [1] [2]	Percent of fiscal year 1983 [2] expenditures	Fiscal year 1984 balance [1] [2]	Percent of fiscal year 1984 [2] expenditures
Utah	30	3.39	15	1.52	17	1.68
Vermont	0	.00	−18	−5.57	−11	−3.22
Virginia	198	8.34	0	.00	1	.03
Washington	251	7.81	5	.14	−79	−2.02
West Virginia	78	6.32	8	.61	18	1.32
Wisconsin	71	2.06	−286	−6.67	62	1.47
Wyoming	157	51.99	21	4.71	15	3.36
Total	4,511	3.01	291	.18	1,263	.73

[1] Figures in millions.
[2] All figures are estimates.

Source: Fiscal Survey of the States, 1983, National Governors Association, National Association of State Budget Officers (June 1983.)

TABLE 7.—STATE TAXES AND EXPENDITURES

	Total State expenditures [1]	Percent of GNP	Direct State expenditures [1] [2]	Percent of GNP	Own funds State expenditures [1] [3]	Percent of GNP	Total State revenues [1]	Percent of GNP	Own source State revenues [1] [4]	Percent of GNP
Fiscal year:										
1922	$1.4	n.a.	$1.1	n.a.	$1.3	n.a.	$1.4	n.a.	$1.2	n.a.
1927	2.0	n.a.	1.5	n.a.	1.9	n.a.	2.2	n.a.	2.0	n.a.
1932	2.8	4.2	2.0	3.0	2.6	3.9	2.5	3.7	2.3	3.4
1934	3.5	5.8	2.1	3.5	2.5	4.1	3.4	5.6	2.5	4.1
1936	3.9	5.0	2.4	3.1	3.1	4.0	4.0	5.2	3.3	3.8
1938	4.6	5.2	3.1	3.5	4.0	4.6	5.3	6.0	4.6	5.2
1940	5.2	5.4	3.6	3.8	4.5	4.7	5.7	6.0	5.0	5.2
1942	5.3	3.8	3.6	2.6	4.5	3.2	6.9	5.0	6.0	4.3
1944	5.2	2.6	3.3	1.6	4.1	2.0	7.7	3.8	6.7	3.3
1946	7.1	3.5	5.0	2.5	6.2	3.1	8.6	4.3	7.7	3.8
1948	11.2	4.6	7.9	3.2	9.5	3.9	11.8	4.8	10.1	4.1
1950	15.1	5.7	10.9	4.1	12.8	4.8	13.9	5.2	11.5	4.3
1952	15.8	4.7	10.8	3.2	13.3	3.9	16.8	5.0	14.3	4.2
1954	18.7	5.17	13.0	3.6	15.8	4.3	18.8	5.2	16.0	4.4
1956	21.7	5.3	15.1	3.7	18.4	4.5	22.2	5.4	18.9	4.6
1957	24.2	5.6	16.8	3.9	20.4	4.7	24.7	5.7	20.7	4.8
1958	28.1	6.3	20.0	4.5	23.3	5.3	26.2	5.9	21.4	4.9
1959	31.1	6.6	22.4	4.7	25.1	5.3	29.2	6.2	22.9	4.8
1960	31.6	6.3	22.2	4.5	25.0	5.0	32.8	6.6	26.1	5.2
1961	34.7	6.8	24.6	4.8	28.2	5.5	34.6	6.8	27.8	5.5
1962	36.4	6.6	25.5	4.7	29.2	5.3	37.6	6.9	30.1	5.5
1963	39.6	6.9	27.7	4.8	31.8	5.5	41.0	7.1	32.8	5.7
1964	42.6	6.9	29.6	4.8	33.4	5.4	45.2	7.3	35.7	5.8
1965	45.6	6.9	31.5	4.8	35.7	5.4	48.8	7.4	38.5	5.8
1966	51.1	7.1	34.2	4.7	39.1	5.4	55.2	7.6	43.0	5.9
1967	58.8	7.6	39.7	5.1	45.1	5.8	61.1	7.9	46.8	6.0
1968	66.3	8.0	44.3	5.3	50.0	6.0	68.5	8.2	52.5	6.3
1969	74.2	8.1	49.4	5.4	56.6	6.2	77.6	8.5	59.8	6.6
1970	85.1	8.8	56.2	5.8	64.7	6.7	88.9	9.2	68.7	7.1
1971	98.8	9.6	66.2	6.4	75.9	7.4	97.2	9.4	73.4	7.1
1972	109.3	9.7	72.5	6.4	81.2	7.2	112.3	9.9	84.4	7.5
1973	118.8	9.5	78.0	6.2	87.6	7.0	129.8	10.4	97.1	7.8
1974	132.1	9.6	86.2	6.2	100.5	7.3	140.8	10.2	107.6	7.8

1975	158.9	10.7	106.9	7.2	122.2	8.3	157.0	10.6	119.2	8.1
1976	180.9	11.0	123.1	7.5	127.7	7.8	183.8	11.2	139.1	8.5
1977	191.2	10.7	128.8	7.2	137.7	7.7	204.4	11.5	155.8	8.7
1978	203.8	10.1	136.5	6.7	149.5	7.4	225.0	11.1	171.6	8.5
1979	224.7	9.8	148.7	6.5	168.6	7.4	247.1	10.8	190.0	8.3
1980	257.8	10.2	173.3	6.9	194.4	7.7	277.0	11.0	213.6	8.5
1981	291.8	10.5	198.3	7.1	220.7	7.9	310.8	11.2	240.0	8.6
1982	310.3	10.3	211.5	7.0	241.2	8.0	330.9	11.0	261.8	8.7

[1] Figures in billions.
[2] Total state expenditures minus payments to local and Federal governments.
[3] Total state expenditures minus funds from Federal and local governments.
[4] Total state revenues minus payments from Federal and local governments.
N.a.—Not available.

Source: Tax Foundation, Inc., Facts and Figures on Government Finance, 1981; U.S. Bureau of the Census, State Government Finances in 1982.

TABLE 8.—COMPOSITION OF STATE SPENDING, FISCAL YEAR 1982

Spending category	Total [1] expenditures	Percent of total	Direct [1] expenditures	Percent of direct
Education	$103.0	33.2	$42.3	20.0
State institutions of higher education	(34.3)	(11.1)	(34.3)	(16.2)
Welfare	55.3	17.8	41.5	19.6
Medical care payments	(24.3)	(7.8)	(24.3)	(11.5)
Hospitals	13.9	4.5	13.9	6.6
Other health	8.3	2.7	8.3	3.9
Highways	25.1	8.1	20.1	9.5
Police and corrections	8.6	2.8	8.6	4.1
Natural resources	5.5	1.8	5.5	2.6
Parks and recreation	1.7	0.5	1.7	0.8
Debt interest	9.0	2.9	9.0	4.3
Insurance trust expenses	34.7	11.2	34.7	16.4
Employee retirement	(13.1)	(4.2)	(13.1)	(6.2)
Unemployment compensation	(18.0)	(5.8)	(18.0)	(8.5)
Workmen's compensation	(2.5)	(0.8)	(2.5)	(1.2)
Liquor stores	2.4	0.8	2.4	1.1
Utilities	3.7	1.2	3.7	1.7
Other	39.1	12.6	19.8	9.4
Total	310.3		211.5	

[1] Figures in billions.

Source: U.S. Bureau of Census, State Government Finances in 1982.

TABLE 9.—COMPOSITION OF STATE REVENUES, FISCAL YEAR 1982

Revenue source	Amount [1]	Percent of total revenues	Percent of own source revenues
Intergovernmental revenue [2]	$69.2	20.9	
Sales taxes	78.8	23.8	30.0
General	(50.3)	(15.2)	(19.2)
Selective	(28.5)	(8.6)	(10.9)
Individual income taxes	45.7	13.8	17.5
Corporate income taxes	14.0	4.2	5.3
User fees [3]	26.0	7.9	9.9
License taxes	10.1	3.1	3.9
Insurance trust revenue [4]	50.8	15.4	19.4
Miscellaneous revenue [5]	22.3	6.7	8.5
Other taxes [6]	14.0	4.2	5.3
Total	330.9		

[1] Amounts in billions.
[2] Federal grants-in-aid and minor receipts from local governments.
[3] Includes revenue from State liquor stores and utilities.
[4] Includes revenues from Employee Retirement, Unemployment Compensation, Workmen's Compensation and other trust funds.
[5] Includes interest earnings, rents and royalties, donations, fines and forfeits, sale of property and other revenue.
[6] Includes severance taxes, property taxes, death and gift taxes, documentary and stock transfer taxes, and other taxes.

Source: U.S. Bureau of Census, State Government Finances in 1982.

TABLE 10.—ACTUAL AND ANTICIPATED CURRENT SURPLUS AND DEFICIT BY CITY SIZE, FISCAL YEAR 1981–83

[In percent]

	1981	1982	1983 budgeted
Small cities: (population 10,000–49,000):			
Percent in surplus	57.0	56.0	35.0
Surplus as a percentage of expenditures	12.2	15.2	9.8
Percent in deficit	43.0	44.0	65.0
Deficit as a percentage of expenditures	8.2	10.1	10.6

TABLE 10.—ACTUAL AND ANTICIPATED CURRENT SURPLUS AND DEFICIT BY CITY SIZE, FISCAL YEAR 1981–83—Continued

[In percent]

	1981	1982	1983 budgeted
Medium cities: (population 50,000–99,999):			
Percent in surplus	65.0	53.0	40.0
Surplus as a percentage of expenditures	16.9	15.4	13.4
Percent in deficit	35.0	47.0	60.0
Deficit as a percentage of expenditures	7.1	7.5	8.5
Large cities (population 100,000–249,000):			
Percent in surplus	71.0	60.0	29.0
Surplus as a percentage of expenditures	10.0	8.2	10.1
Percent in deficit	29.0	40.0	71.0
Deficit as a percentage of expenditures	8.8	9.3	9.5
Largest cities (population 250,000 and over):			
Percent in surplus	56.0	56.0	40.0
Surplus as a percentage of expenditures	9.2	7.2	5.4
Percent in deficit	44.0	44.0	60.0
Deficit as a percentage of expenditures	5.0	5.1	6.7
All cities:			
Percent in surplus	62.0	57.0	36.0
Surplus as a percentage of expenditures	12.3	12.4	10.0
Percent in deficit	38.0	43.0	64.0
Deficit as a percentage of expenditures	7.6	8.6	9.4

Source: Joint Economic Committee and Municipal Finance Officer Association, Trends in the Fiscal Conditions of Cities, 1981–83 (November 1983).

TABLE 11.—LOCAL TAXES AND EXPENDITURES

	Total [1] local expenditures	Percent of GNP	Own funds [1] local expenditures	Percent of GNP	Total [1] local revenues	Percent of GNP	Own source local [1] revenues	Percent of GNP
Fiscal year:								
1922	$4.6	n.a.	$4.3	n.a.	$4.1	n.a.	$3.8	n.a.
1927	6.4	n.a.	5.8	n.a.	6.3	n.a.	5.7	n.a.
1932	6.4	9.5	5.6	8.3	6.2	9.2	5.4	8.0
1934	5.7	9.4	4.3	7.1	6.4	10.6	5.0	8.3
1936	6.1	7.9	4.4	5.7	6.8	8.8	5.1	6.6
1938	6.9	7.8	5.3	6.0	7.3	8.3	5.6	6.4
1940	7.7	8.1	5.8	6.1	7.7	8.1	5.8	6.1
1942	7.4	5.3	5.6	4.0	8.1	5.8	6.3	4.5
1944	7.2	3.6	5.4	2.7	8.5	4.2	6.7	3.3
1946	9.1	4.5	7.0	3.5	9.6	4.8	7.4	3.7
1948	13.4	5.5	10.0	4.1	13.2	5.4	9.7	4.0
1950	17.0	6.4	12.8	4.8	16.1	6.1	11.7	4.4
1952	20.2	6.0	14.9	4.4	19.4	5.7	14.1	4.2
1954	23.8	6.5	17.8	4.9	22.4	6.2	16.5	4.5
1956	28.3	6.9	21.4	5.2	26.4	6.4	19.5	4.7
1957	31.1	7.2	23.3	5.4	29.0	6.7	21.4	4.9
1958	34.0	7.7	25.5	5.8	31.3	7.1	23.0	5.2
1959	36.3	7.7	27.1	5.7	33.6	7.1	24.7	5.2
1960	39.1	7.9	29.0	5.8	37.3	7.5	27.2	5.5
1961	42.6	8.4	31.8	6.2	40.5	8.0	29.6	5.8
1962	45.3	8.3	33.6	6.1	43.1	7.9	31.5	5.7
1963	47.2	8.2	34.4	6.0	45.6	7.9	33.0	5.7
1964	51.2	8.3	37.0	6.0	49.6	8.0	35.7	5.8
1965	55.5	8.4	39.9	6.1	53.4	8.1	38.2	5.8
1966	61.0	8.4	42.7	5.9	59.3	8.2	41.5	5.7
1967	66.6	8.6	45.9	5.9	64.6	8.3	44.4	5.7
1968	72.4	8.7	48.1	5.8	70.2	8.4	47.9	5.8
1969	82.7	9.7	55.6	6.1	79.3	8.7	53.2	5.8
1970	92.5	9.5	60.1	6.2	89.1	9.2	59.6	6.2
1971	105.2	10.2	67.4	6.5	101.0	9.8	66.5	6.4
1972	118.6	10.5	75.7	6.7	114.8	10.2	75.1	6.7
1973	128.3	10.2	76.6	6.1	129.1	10.3	91.3	6.5
1974	140.4	10.2	82.7	6.0	143.1	10.4	88.4	6.4

1975	162.6	11.0	97.4	6.6	159.7	10.8	97.8	6.6
1976	181.8	11.1	107.5	6.6	178.3	10.9	108.6	6.6
1977	196.3	11.0	112.1	6.3	196.5	11.0	119.6	6.7
1978	211.1	10.4	118.1	5.8	214.5	10.6	130.5	6.4
1979	233.3	10.2	128.1	5.6	234.6	10.2	139.9	6.1
1980	261.5	10.4	156.6	6.2	259.8	10.3	154.9	6.1
1981	288.6	10.4	177.2	6.4	287.8	10.3	176.4	6.3
1982	311.4	10.4	195.4	6.5	313.1	10.4	197.2	6.6

[1] Figures in billions.

N.a.—Not available.

Source: Compiled from data from, Tax Foundation, Inc., Facts and Figures on Government Finance, 1981; U.S. Bureau of the Census, State Government Finances in 1982; U.S. Bureau of the Census, Governmental Finance in 1979–1980; 1980–1981; 1981–1982 Advisory Commission on Intergovernmental Relations, Significant Features of Fiscal Federalism, 1981–82.

TABLE 12.—COMPOSITION OF LOCAL GOVERNMENT SPENDING, FISCAL YEAR 1982

Spending category	Amount [1]	Percentage of total
Education	$112.3	36.1
Welfare	14.7	4.7
Health and hospitals	20.9	6.7
Highways	14.4	4.6
Police protection	14.1	4.5
Fire protection	6.9	2.2
Corrections	3.0	1.0
Sewers	10.4	3.3
Garbage collection	4.1	1.3
Parks and recreations	7.4	2.4
Housing and urban renewal	7.6	2.4
Debt interest	11.0	3.5
Employee retirement	4.7	1.5
Utilities	41.4	13.3
Water supply	(11.5)	(3.7)
Electric power	(18.1)	(5.8)
Mass transit	(9.2)	(3.0)
Gas supply	(2.6)	(.8)
Other	38.5	12.4
Total	311.4	

[1] Amounts in billions.

Source: U.S. Bureau of the Census, Governmental Finances in 1981–1982, State Government Finances in 1982.

TABLE 12A.—COMPOSITION OF CITY GOVERNMENT SPENDING, FISCAL YEAR 1981

Spending category	Amount [1]	Percentage of total
Education	$9.9	9.5
Welfare	4.1	3.9
Health and hospitals	4.6	4.4
Highways	6.7	6.4
Police protection	9.0	8.6
Fire protection	5.0	4.8
Corrections	0.6	0.6
Sewers	6.2	5.9
Garbage collection	2.9	2.8
Parks and recreations	3.7	3.5
Housing and urban renewal	4.1	3.9
Debt interest	3.6	3.4
Utilities	21.3	20.4
Water supply	(6.9)	(6.6)
Electric power	(10.1)	(9.7)
Mass transit	(2.5)	(2.4)
Gas supply	(1.8)	(1.7)
Employee retirement	3.4	3.3
Other	19.4	18.6
Total	104.5	

[1] Amounts in billions.

Source: U.S. Bureau of the Census, Governmental Finances in 1980–1981.

TABLE 12B.—PER CAPITA COMPOSITION OF CITY GOVERNMENT SPENDING, BY CITY SIZE, FISCAL YEAR 1981

[Amounts in dollars]

Spending category	All cities	1,000,000 or more	500,000 to 999,999	300,00 to 499,999	200,000 to 299,999	100,000 to 199,999	50,000 to 99,999	Less than 50,000
Education	70.41	204.75	104.08	53.73	95.89	100.70	66.19	24.40
Welfare	28.74	174.68	47.43	10.75	12.42	7.98	3.25	1.56
Hospitals and health	32.82	93.50	61.21	35.05	23.01	23.54	20.65	17.22
Police	63.56	110.67	84.62	77.12	68.31	64.12	57.72	46.34
Fire	35.28	49.00	44.94	49.51	47.31	46.09	40.03	23.43
Sewers	44.23	63.72	64.05	49.71	39.63	42.79	38.58	36.90
Garbage collection	20.74	35.88	26.08	24.00	29.22	19.25	17.40	15.76
Parks and recreation	26.55	25.79	43.82	44.89	40.91	34.44	27.90	17.85
Housing and urban renewal	29.43	89.17	43.13	39.97	39.63	28.30	26.92	9.62
Debt interest	25.87	48.83	38.48	36.25	34.89	25.92	20.48	16.64
Utilities	151.39	223.69	197.8	148.12	141.19	165.43	104.13	134.94
Water	(48.91)	(36.91)	(49.16)	(58.85)	(63.56)	(45.79)	(43.33)	(51.40)
Employment retirement	26.60	129.53	49.41	27.62	19.00	14.11	8.88	3.13
Other	138.06	267.57	210.53	206.28	166.04	137.13	115.96	84.34
Total	741.53	1,558.34	1,078.68	853.01	803.66	761.26	594.79	478.10

Source: U.S. Bureau of the Census, City Government Finances in 1980–1981.

TABLE 13.—COMPOSITION OF LOCAL GOVERNMENT REVENUE, FISCAL YEAR 1982

Revenue source	Amount [1]	Percentage of total	Percentage of own source revenues
Intergovernmental	$116.0	37.0	
From Federal Government	(20.9)	(6.7)	
From State government [2]	(95.0)	(30.3)	
Property taxes	78.8	25.2	40.0
Income taxes	6.1	1.9	3.1
Individual	(5.1)	(1.6)	(2.6)
Corporate	(1.0)	(0.3)	(0.5)
Sales taxes	14.8	4.7	7.5
General	(10.2)	(3.3)	(5.2)
Selective	(4.6)	(1.5)	(2.3)
User fees [3]	63.7	20.3	32.3
Utility revenue	(28.2)	(9.0)	(14.3)
Miscellaneous revenue [4]	24.6	7.9	12.5
Insurance trust revenue	5.3	1.7	2.7
Other	3.9	1.2	2.0
Total	313.1		

[1] Amounts in billions.

[2] A substantial proportion of these funds may be grants States initially received from the Federal Government to distribute to local governments.

[3] Includes utility revenue and liquor store revenue, $28.7 billion.

[4] Includes interest earnings, special assessments, sale of property and others.

Source: U.S. Bureau of the Census, Governmental Finances in 1981–1982.

TABLE 13A.—COMPOSITION OF CITY GOVERNMENT REVENUES, FISCAL YEAR 1981

Revenue source	Amount [1]	Percentage of total	Percentage of own source revenues
Intergovernmental revenue	$29.8	28.3	
From Federal Government	(11.3)	(10.7)	
From State governments [2]	(17.0)	(16.1)	
From Local governments	(1.6)	(1.5)	
Property taxes	18.3	17.4	24.2
Sales taxes	9.0	8.5	11.9
General	(5.6)	(5.3)	(7.4)
Selective	(3.3)	(3.1)	(4.3)
Income taxes	4.5	4.3	6.0
Nonutility user fees [3]	11.5	10.9	15.2
Utility user fees	18.1	17.2	23.9
Electric power	(9.5)	(9.0)	(12.6)
Water supply	(5.6)	(5.3)	(7.4)
Mass transit	(1.2)	(1.1)	(1.6)
Gas supply	(1.8)	(1.7)	(2.3)
Employee retirement trust funds	3.6	3.4	4.8
Miscellaneous revenues [4]	5.2	4.9	6.9
Other	5.4	5.1	7.1
Total	105.4		

[1] Amount in billions.

[2] A substantial portion of these funds may be grants to States initially received from the Federal Government for distribution to cities.

[3] Includes liquor store revenues—$.3 billion.

[4] Includes interest earnings, special arrangements and sale of property.

TABLE 13B.—PER CAPITA COMPOSITION OF CITY GOVERNMENT REVENUES, BY CITY SIZE, FISCAL YEAR 1982

[Amounts in dollars]

Revenue source	All cities	1,000,000 or more	500,000 to 999,999	300,000 to 499,999	200,000 to 299,999	100,000 to 199,999	50,000 to 99,999	Less than 50,000
Intergovernmental:	211.70	544.87	368.46	258.59	237.26	216.96	154.48	100.49
Federal	(80.05)	(150.55)	(183.20)	(129.24)	(104.47)	(85.36)	(56.62)	(38.85)
State [1]	(120.559)	(386.45)	(170.20)	(114.68)	(117.81)	(116.73)	(90.21)	(51.18)
Local	(11.06)	(7.87)	(15.07)	(14.66)	(14.98)	(14.88)	(7.66)	(10.47)
Property taxes	129.67	260.88	178.89	116.09	116.35	152.93	138.94	82.37
Sales taxes	63.54	157.68	90.05	87.67	75.98	56.52	47.42	34.70
Income taxes	32.14	154.66	55.96	28.92	32.33	5.22	7.72	7.61
Miscellaneous [2]	57.48	79.87	69.99	87.17	65.94	57.83	53.08	45.25
User fees	208.15	313.88	274.02	216.90	194.34	223.18	159.06	178.19
Utility	(128.69)	(183.52)	(165.20)	(118.29)	(107.95)	(135.67)	(89.16)	(119.95)
Nonutility	(79.46)	(130.36)	(108.82)	(98.61)	(86.39)	(87.51)	(69.90)	(58.24)
Other	16.60	31.66	26.60	24.10	20.27	15.34	12.01	10.86
Total [3]	719.27	1,543.49	1,063.96	819.43	742.47	727.97	573.21	459.48

[1] A substantial portion of these funds may be granted to States initially received from the Federal Government for distribution to cities.
[2] Includes interest earnings, special arrangements, and sale of property.
[3] Does not include liquor store revenues and employee retirement trust fund revenues.

Source: U.S. Bureau of the Census, City Government Finances in 1980–81.

ANNEX B. FOOTNOTES

Chapter II

1. *Budget of the United States Government, FY85,* (February 1984).

2. Special Analysis H, "Federal Aid to State and Local Governments," *Special Analysis Budget of the United States Government, FY84, (January 1983).*

3. *Fiscal Survey of the United States 1983,* National Governors Association, National Association of State Budget Officers, (June 1983), p. 10. Vermont is the only state without such a restriction.

4. Ibid. Excluding Texas, the other 49 states had an aggregated deficit at the end of fiscal 1983 of $339 million. The 50 states' aggregate balance in FY83 was only two-tenths of one percent of current state expenditures, down from nearly ten percent in 1979.

5. Ibid, pp. 1, 6.

6. Joint Economic Committee and Municipal Finance Officer Association, *Trends in the Fiscal Conditions of the Cities, 1981–1983,* (November 1983).

7. Ibid at 14.

8. Frances Viscount, National League of Cities, City Fiscal Conditions and Outlook for Fiscal 1984: Resourcefulness vs. Resources, Working Paper No. 14, December 1983.

9. Ibid.

10. Considering local own source revenues alone, property taxes are still the most important source at 40 percent. User fees, including utilities and liquor stores, are now close behind at 32.3 percent. Together, these two revenue sources account for three fourths of local own source revenues. Considering own source revenues alone, total user fees defined as noted would now be the most important source at 39.1 percent, with property taxes second at 24.2 percent, together accounting for two thirds of own source revenues.

11. JEC/MFOA, Trends in the Fiscal Conditions of Cities, 1981–1983, National League of Cities, City Fiscal Conditions and Outlook for Fiscal 1984: Resourcefulness vs. Resources.

12. The JEC/MFOA report found that tax city revenues in 1982 grew by 6.3 percent, less than the 7.1 inflation rate faced by city governments, but expenditures grew by 8.07 percent, in a year when real GNP growth was negative. The National League of Cities report found revenue growth in 1983 to be 6.4 percent, while expenditures grew by 9.5 percent, a 3.5 percent real expenditure growth rate as compared to city government inflation of 6.0 percent. For 1984, revenues were projected to grow by 5.0 percent, even with inflation, but expenditures were expected to grow by 6.1 percent.

13. E.S. Savas and Barbara J. Stevens, *Evaluating the Organization of Service Delivery: Solid Waste Collection and Disposal,* New York: Columbia University Graduate School of Business, 1977. See also E.S. Savas, The Organization and Efficiency of Solid Waste Collection (Lexington, MA: Lexington Books, 1977); E.S. Savas, "Policy Analysis for Local Government: Public vs. Private Refuse Collection," *Policy Analysis,* Vol. 3, no. I, (winter 1977) pp. 49–74; E.S. Savas and Barbara J. Stevens, "The Cost of Resident Refuse Collection and the Effect of Service Arrangement," *Municipal Year Book,* pp. 200–205, International City Management Association, Washington, DC, 1977: E.S. Savas, "Public vs. Private Waste Collection: A Critical Review of the Evidence," *Urban Analysis,* 1979, Vol. 6, pp. 5–6.

14. To consider the private firm costs on an equivalent basis with public sector bureaucracies, Savas and Stevens properly did not consider the taxes on profits of such firms as costs. Taxes are not a cost of private garbage collection. They are a thoroughly exogenous factor determined by government. They should, in fact, be considered an additional benefit of private garbage collection rather than a cost because, in the case of such privatization, they represent new revenues used to provide government goods and services to the public.

In addition, profits are economically the fee paid for the capital contributed to the firm by the owner. When a city provide garbage collection, the taxpayer has this cost as well. The taxpayers lose the interest on the tax money invested as capital in the public garbage collection department. Since this foregone interest is not included by Savas and Stevens in their computation of municipal garbage collection costs, they properly excluded it from their compilation of private costs.

Moreover, even without adjusting for the profits and taxes of the private firms, Savas and Stevens still found municipal collections to cost 29 to 37 percent more than for private firms under contract with city governments. See the sources cited in Footnote 17.

15. D.G. Davies, "The Efficiency of Public Versus Private Firms, The Case of Australia's Two Airlines, Journal of Law and Economics, Vol. 14, No. 1 (April 1971), pp. 149–165.

16. Cotton M. Lindsay, *Veterans Administration Hospitals*, (Washington, DC: American Enterprise Institute, 1975), p. 11.

17. Other options involve the provision of services by private firms through government funding. Public grants may be provided to organizations to subsidize a continuing service. The private entity in such cases also charges customers a price for the service. In many instances, states or cities can get a service provided through this means at relatively small expense to themselves. Alternatively, vouchers can be issued to consumers to be used for purchasing private sector services. These vouchers are then submitted to the government by the private firm for cash payment. In essence, the voucher provides additional demand in the private market, while assisting low income individuals in purchasing the goods or service. Consumers, thus retain their freedom to select a specific supplier, maximizing the competitive potential.

18. The results of this study are reported in International City Management Association, "Alternative Approaches to Delivering Public Services," *Urban Data Service Report*, Vol. 14, No. 10, October 1982; Harry P. Hatry and Carl F. Valente, "Alternative Service Delivery Approaches Involving Increased Use of the Private Sector," *The Municipal Year Book, 1983*, (Washington, D.C.: International City Management Association, 1983); Harry P. Hatry, Urban Institute, "Alternative Service Delivery Approaches Involving Increased Use of the Private Sector," (June 1983); Robert W. Poole, Jr., "Privatization: How Widespread?" *Fiscal Watchdog*, January 1983.

19. As were franchising arrangements, operating successfully by local governments for private sector servicing of commercial solid waste collection (17%), residential solid waste collection (15%), airport operation (9%), solid waste disposal (7%), vehicle towing (7%), ambulance service (4%) and bus services (4%).

20. Such policies are applicable at least in part to all state and local authorities except for welfare and unemployment compensation (5 percent of local spending and about 30 percent of state direct spending). Indeed, theoretically all such services could be entirely provided through one or more of the privatization mechanisms we have discussed. Strictly speaking, only simple income redistribution spending cannot be adapted to a competitive private-sector oriented structure (although non-competitive private-sector institutions could conceivably perform these functions, at least partially). But custom and tradition are likely to limit what is practically, rather than theoretically, possible.

21. For further discussion of the reasons why private competition is likely to be superior to government monopoly, the empirical evidence supporting such analysis, and examples of successful privatization efforts by state and local governments, see Savas, *Privatizing the Public Sector;* Poole, *Cutting Back City Hall;* Bennett and Johnson, "Tax Reductions Without Sacrifice," and the sources cited in Footnote 37.

22. Bell Report.

23. Ibid; Reagan speaker.

24. Pat Choate and Susan Walter, *America in Ruins*, (Washington, DC: Council of State Planning Agencies, 1981).

25. Ibid, p. 1.

26. Ibid, pp. 15–16.

27. Charles Tiebout, "Pure Theory of Local Expenditures," *Journal of Political Economy*, October 1956.

28. Wallace Oates, "The Effect of Property Taxes and Local Spending on Property Value: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis," *Journal of Political Economy*, November/December 1969.

29. James R. Follain, Jr. and Stephen Malpezzi, *Dissecting Housing Value and Rent*, (Washington, DC: Urban Institute, 1980).

30. Ibid.

31. Revzan, Larry, "Results of Research on Location Economics," *Sourcebook on Enterprise Zones*, (Washington, DC: Sabre Foundation, 1981).

32. Joint Economic Committee, "State and Local Economic Development Strategy: A 'Supply-Side' Perspective," (Washington, DC, October 26, 1981).

33. Francis Viscount, City Fiscal Conditions and Outlook for Fiscal 1984: Resourcefulness vs. Resources; National League of Cities, Working Paper No. 14, pp. 27–29.

34. One particular tax increase would have specially interrelated effects on the problems we have discussed. State and local non-business income taxes, sales taxes and property taxes are currently deductible from income when calculating Federal tax liability, resulting in an estimated Federal revenue loss of over 30 billion for fiscal 1985. Proposals have been advanced in Congress to eliminate this deductibility and thus recapture this revenue. But while helping to solve Federal fiscal problems, eliminating such deductibility would only worsen state and local fiscal difficulties.

35. John W. Ellwood, ed., *Reductions in U.S. Domestic Spending* (New Brunswick, NJ: Basic Books, 1982), pp. 39–43.

36. Ellwood, ed., *Reductions in U.S. vs. Domestic Spending,* Table 1.11.

37. Richard P. Nations and Fred C. Doolittle, *The Consequences of Cuts* (Princeton, NJ: Princeton University, 1983), p. 2.

38. Nathan and Doolittle, *The Consequence of Cuts;* Ellwood, *Reductions in U.S. Domestic Spending;* Palmer and Sawhill, *The Reagan Experiment.*

39. Ibid.

40. Nathan and Doolittle, *Consequences of Cuts,* p. 122.

41. Palmer and Sawhill, *The Reagan Experiment,* Chapter 16.

42. Grace Commission Report. See also Heritage study by John Palffy.

CHAPTER III

1. Interview with Douglas Kleine, research director, Community Associations Institute.

2. Interview with William R. Bosse, former president, Waterman Place Association, St. Louis.

3. Interview with Bernard Steiner, property manager, Glen Oaks Cooperative, The Bronx.

4. ———, *Homes Association Handbook,* Urban Land Institute, Washington, DC 1964, Chapters 2 and 3.

5. Newman, Oscar, *Community of Interest,* Doubleday, New York, 1980, Chapter 12.

6. Interview with Bosse, op. cit.

7. Interview with Peter Behringer, a private developer in Baltimore, and Roger Wilcox, Technicoop. See also Federal Home Loan Bank Board Report on Community Investment Fund, CAI Reprint Series, p. 11.

8. Taylor, Joe, "Crime Fighters," Washington Post, February 28, 1981, pp. E29–30.

9. Joelson, Mitchell and Gray, Charles M., "Neighborhood Crime and the Demand for Central City Housing," in the *Costs of Crime,* Charles M. Gray, editor, Sage Publications, Beverly Hills, 1979, p. 53.

10. Interview with Winfield Sealander, Sealander Brokerage, Washington, DC.

11. *Homes Association Handbook,* op. cit.

12. Frazier, Mark and Wax, Barry, *Neighborhood Revival,* Sabre Foundation, Washington, DC 1983, pp. III–9 through III–12.

13. Ibid, p. III–10.

14. Ibid, p. III–13.

CHAPTER IV

1. The enterprise association concept was introduced in the *Sourcebook on Enterprise Zones,* Sabre Foundation, Washington, DC 1981, Chapter IV. Prototype legislation for enterprise associations, contained in the Sourcebook, was later adopted with minor changes by the Commonwealth of Kentucky.

2. Interview with Robert O. Zdenek and Henry McCarty, National Trust for Historic Preservation.

3. Ibid.

4. *Neighborhood Revival,* op. cit., pp. III–9 through III–13.

5. Schill, Michael S. and Nathan, Richard P., *Revitalizing America's Cities: Neighborhood Reinvestment and Displacement,* State University of New York Press, 1983.

6. Internal Revenue Service Revenue Ruling 80–63, Washington, DC 1980.

7. UPI, "Tax Deductions Sought for Association Fees," Washington Post, July, 1982, p. E–2.

8. Interview with Theresa Stankus, Staff Attorney, City of Houston.

9. Interview with Robert O. Zdenek, op. cit.

10. Enterprise Zone Statute, Commonwealth of Kentucky, 1983.

11. ———, *The Urban Homesteading Assistance Board: Current Programs and Projects*, New York City, June 1983.

12. Anderson, Marla, "Neighborhood-Based Service Delivery," IOMA Management Information Service, October, 1983.

13. With the exception of a handful of homeowners' associations that have blanket policy coverage, group policies are limited to the estimated 25,000 condominium associations and 5,000 residential cooperatives. With an average membership of 200 households per association, the maximum number of households covered is 6 million.

14. Interviews with Barbara Wick, Condominium Insurance Specialists of America, and Jeff Brown, Valley Forge Insurance Management.

15. *Community of Interest*, op. cit.

16. As part of a move to secure new office space, the Sabre Foundation and an associated nonprofit group, FZA Ltd., will implement a challenge grant program for neighborhood association startup.

17. Interview with Winfield Sealander, op. cit.

CHAPTER V

1. Table V-1 estimates for projected outlays in the five chosen federal services were obtained directly from the 1985 Federal Budget books issued by the Office of Management and Budget, General Finance volume.

2. Projected outlays for the selected federal services in Table V-1 were multiplied by 5 percent, 10 percent, and 15 percent to estimate potential savings to the Federal Government resulting from promotion of neighborhood self-sufficiency.

3. Table V-2's figures for the 1982 baseline local service expenditures were obtained from the Census Bureau's 1982 *Annual Census on Government Finance* (Table 13: State and Local Government Expenditures by Function and Level of Government, by State 1981-1982). Figures for 1982 were unavailable for Parks and Recreation and Transit programs.

The Table V-2 estimates of annual growth rates in service expenditures were derived by extrapolating from a baseline of 1977 expenditures found in the Census Bureau's five year Census on Government Finances (Table 47: Finances of the State and Local Governments, by Level of Government and by State, 1977-1978). The extrapolation was accomplished by:

(*a*) Using the total general expenditures of local governments in the US from 1978-1982 to calculate the average annual increase of the total costs of these services. Figures were deflated through the GNP Implicit Price Deflator in order to obtain an average annual increase in real terms.

(*b*) This increase, found to be 1.12 percent, then served as the basis for making the yearly extrapolations.

(*c*) Inflation was factored in using the CPI figures issued by the OMB in January 1984.

4. As depicted in the lower portion of Table V-2, the cumulative projected service expenditures were then multiplied by 5 percent, 10 percent and 15 percent in order to obtain an estimate of the potential total savings to local governments resulting from a strengthening of neighborhood self-help organizations.

5. Table V-3 reflects estimates only; no direct statistics exist on Federal tax losses due to the deductibility of local taxes alone. The reason is that state taxes as well as local taxes are deductible from Federal income taxes; consequently, Federal income tax return forms do not separate between deductions due to local taxes. To develop estimates reflecting solely the Federal tax loss attributable to locally paid taxes, a ratio was established. This ratio was drawn from the amount of tax revenue (1982) collected at a state level vs. the amount of tax revenue collected at a local level (school districts excluded). [Source: Significant Features of Fiscal Federalism, 1982-3 edition, Advisory Commission on Intergovernmental Relations, p. 36]. Local taxes were found to equal 29.5 percent of the combined state and local taxes for 1982. This percentage was then multiplied against the OMB figures for federal revenue losses due to the deductibility of non-business state and local taxes (Special Analysis G, op. cit.). Although the resulting number is a reasonable estimate, it is necessarily only an approximation in that business taxes were included in the figures for 1982 state and local revenue but excluded in the OMB figures.

The average annual increase in Federal revenue losses due to the deductibility of local taxes (for property, income and sales) was determined through a review of the two following statistical categories, contained in Section G of the OMB's Special Analysis of the Federal Budget:

Deductibility of State and Local Property Taxes on Owner Occupied Homes.

Deductibility of Non-Business State and Local Taxes other than on Owner Occupied Homes.

The annual sums of these statistical categories were determined for the period 1975–1983. From these, an average yearly real increase in the "deductibility" figures was obtained using the GNP Implicit Price Deflator. This figure was found to be 4.49 percent. Extrapolations were made using this 4.49 percent real increase figure, adjusting it for inflation in line with CPI predictions published by the OMB in January 1984.

To adjust for the fact that not all people itemize (deductibility for local taxes applies basically to itemizers alone) the figures were multiplied by the percentage of people who itemize. The 1981 number for this figure was 31 percent (1981 IRS Statistics of Income publication). This number is assumed to remain constant over the period examined. Then, to account for the actual revenue gain to the Federal government from reduced local tax payments, the figures were multiplied by the average rate of taxation for itemizing individuals: 24 percent. That is, for every one dollar decrease in local taxes paid by itemizing individuals, the federal government would gain $.24. The 24 percent average tax rate was also obtained from the 1981 IRS Statistics of Income, and is assumed to remain constant for the period.

The final figures reflect potential increases in Federal revenues per year due to diminishing deductions of local taxes, based upon reduction in local taxes of 5 percent, 10 percent and 15 percent.

6. Newman, Oscar, *Community of Interest,* Doubleday, New York, 1980, chapter on "The Private Streets of St. Louis," pp. 137–144.

7. Frazier, Mark and Wax, Barry, *Neighborhood Revival; New Roles for Voluntary Organizations,* Sabre Foundation/Department of Housing and Urban Development, September, 1983, Chapter III.

8. Gray, Charles M. and Joelson, Mitchel R., "Neighborhood Crime and the Demand for Central City Housing", in *The Costs of Crime,* Charles M. Gray, (ed.), Russell Sage Publications, Beverly Hills, 1979, p. 53.

9. The figure is calculated on the basis of information from Table 27, page 36 of *Significant Features of Fiscal Federalism,* 1982–83 edition, published by the Advisory Commission on Intergovernmental Relations, Washington, DC.

10. Table V–4 is based upon the research findings of Gray-Joelson in *The Costs of Crime* (op. cit.) regarding the effects of improved crime prevention on property values. They estimated that a 1 percent reduction in the number of residential units burglarized yields an increase in property values of $336 per owner-occupied household. Because this figure was calculated from 1976 data, it was extrapolated in current dollars to 1989 according to yearly CPI estimates issued by the OMB in January of 1984. Assumptions of 15, 30, and 45 percent reductions in crime rates arising from neighborhood organization actions are based upon the experiences of community crime prevention efforts, notably "crime watches." Evidence of the effectiveness of neighborhood crime prevention activities is cited in *The Figgie Report on Fear of Crime,* by Research & Forecasts, Inc., Willoughby, Ohio, 1983, p. 11, and in the authoritative *An exemplary Project: Community Crime Prevention Program-Seattle, Washington,* conducted by Cirel, Evans et al for the U.S. Department of Justice, LEAA, NILECJ, 1977.

To estimate the increase in property tax revenues resulting from appreciated property tax values, project researchers began by calculating the percentage of property taxes charged per owner-occupied household. The calculation of this percentage involved two steps:

(a) First, the average amount of property tax charged per owner-occupied household was found by dividing the total amount of property taxes collected in the US by the total number of owner-occupied homes in the US. This figure came to $687 ($35,618,000,000 divided by 51,794,545).

(b) This figure ($687) was then divided by the average US value of an owner-occupied household ($51,300). The new number obtained, the percentage of the property taxes paid out relative to property value each year, came to 1.3%. [Sources: Figures for the total amount of property taxes collected in the US, the total number of owner-occupied homes in the US and the average US value of an owner occupied house hold were obtained from the 1981 edition of the Annual Housing Survey published by the US Census Bureau.]

To estimate the increase property tax revenue yields on a national basis, project researchers then multiplied the additional revenue per household by the number of owner-occupied households in the US. This step involved extrapolating the number of owner-occupied households in the US from the latest 1981 figures to an estimate of the number in 1989. An estimated average increase was calculated using data from 1976–1981 and found to be 2.5% per year. [Source: the US Census Bureau's Annual Housing Survey].

11. Table V–5 shows potential fiscal impacts arising from private rather than public sector challenge grants. Private sector incentives are assumed to have weaker ability to stimulate assumption of public services by homeowners' associations, principally because they do nothing to relieve the non-deductibility and "double payments" problems.

12. Table V–6 attempts to predict the cost to the federal government of allowing deductibility of homeowners' association fees. The following figures are estimates, based upon field interviews conducted with homeowners' association representatives:

Average deductible association fee	$50
Average number of tax payers per association	200
Total number of associations	25,000

To calculate how much in additional expenditures would be incurred to the federal governments for every deductible dollar, the figures were multiplied by the 1981 24% average tax rate for individuals who itemize deductions (obtained from the 1981 IRS Statistics of Income publication). Secondly, the figures were also multiplied by the average number people in 1981 who itemized, 31% (IRS Statistics of Income). Finally, inflation was factored in using CPI figures issued by the OMB in January 1981.

13. Table V–7 shows the net fiscal impacts upon the federal government of a single public sector incentive (allowing deductibility for a portion of self-assessed fees) to stimulate neighborhood self-sufficiency.

In the first section of the table, benefits of increased neighborhood self-sufficiency are aggregated. These savings include reductions in federal outlays for the programs indicated in Table V–1, and enhanced revenues to the federal government arising from lessened deductions for tax payments as community self-sufficiency grows.

The second section of the table subtracts from the above "fiscal benefit" the amount of revenue that would be lost annually from extending deductibility of a portion of taxpayers' self-assessed fees (see Table V–6). The remainder represents the net fiscal benefit to the federal government likely to result from adoption of the tax relief proposal.

○